PART 74 -- ADMINISTRATION OF GRANTS

Authority: 5 U.S.C. 301; sec. 74.62(a) and Appendix J also issued under sec. 7505, Pub. L. 98 - 502, 98 Stat. 2333 (31 U.S.C. 7505).

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Editorial Note: For additional information, see related documents published at 49 FR 24958, June 18, 1984, 52 FR 20198, May 29, 1987, and 53 FR 8028, March 11, 1988.

Subpart A -- General

REWRITE 74.1 Purpose and scope of this part.

This part establishes uniform requirements for the administration of HHS grants and principles for determining costs applicable to activities assisted by HHS grants.

REWRITE 74.2 Scope of subpart.

This subpart contains general rules pertaining to this Part 74 (definitions, purpose and scope, applicability, and appeals) and procedures for control of deviations from the part.

REWRITE 74.3 Definitions.

As used in this part:

Awarding party means (1) with respect to a grant, the granting agency, and (2) with respect to a subgrant, the grantee. (See REWRITE 74.4(b))

Contract means (except as used in the definitions for grant and subgrant in this section and except where qualified by Federal) a procurement contract under a grant or subgrant, and subcontract means a procurement subcontract under such a contract.

Cost-type contract means a contract or subcontract in which the contractor or subcontractor is paid on the basis of the costs it incurs, but the term does not include such subcontracts under a non-cost-type contract or subcontract.

Expenditure report means: (1) For nonconstruction grants, the Financial Status Report (or other equivalent report); (2) for construction grants, the Outlay Report and Request for Reimbursement for Construction Programs'' (or other equivalent report). (See Subpart I of this part.)

Federally recognized Indian tribal government means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any Native village as defined in section 3 of the Alaska Native Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided by him through the Bureau of Indian Affairs. However, for policies applicable to tribal government hospitals and institutions of higher education, see REWRITE 74.4(c), Applicability of this part.

For-profit organization or institution means a corporation or other legal entity which is organized or operated for the profit or benefit of its shareholders or other owners.

Government means a State or local government or a federally recognized Indian tribal government. However, for policies applicable to government hospitals and institutions of higher education, see REWRITE 74.4(c), Applicability of this part.

Grant means an award of financial assistance in the form of money, or property in lieu of money, by the Federal Government to an eligible recipient. The term includes such financial assistance when provided by

contract, but does not include any Federal procurements subject to the procurement regulations in 41 CFR, nor does it include technical assistance, which provides services instead of money, or other assistance in the form of revenue sharing, loans, loan guarantees, interest subsidies, insurance, or direct appropriations. Also, the term does not include assistance, such as a fellowship or other lump sum award, which the recipient is not required to account for on an actual cost basis.

Grantee means the government, nonprofit corporation, or other legal entity to which a grant is awarded and which is accountable to the Federal Government for the use of the funds provided. The grantee is the entire legal entity even if only a particular component of the entity is designated in the award document. For example, a grant award document may name as the grantee an agency of a State, or one school or campus of a university. In these cases, the granting agency usually intends, or actually requires, that the named component assume primary or sole responsibility for administering the grant-assisted project or program. Nevertheless, the naming of a component of a legal entity as the grantee in a grant award document shall not be construed as relieving the whole legal entity from accountability to the Federal Government for the use of the funds provided. (This definition is not intended to affect the eligibility provisions of grant programs in which eligibility is limited to organizations, such as State welfare departments, which may be only components of a legal entity.) The term grantee does not include any secondary recipients such as subgrantees, contractors, etc., who may receive funds from a grantee pursuant to a grant.

Granting agency means any organizational component of HHS authorized to award and administer grants.

HHS means the U.S. Department of Health and Human Services.

Local government means a local unit of government including specifically a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (whether or not incorporated as a nonprofit corporation under State law), sponsor or sponsoring local organization of a watershed project (as defined in 7 CFR 620.2, 40 FR 12472, March 19, 1975), any other regional or interestate government entity, or any agency or instrumentality of a local government. However, for policies applicable to government hospitals and institutions of higher education, see REWRITE 74.4(c), Applicability of this part.

OMB means the Office of Management and Budget within the Executive Office of the President.

OPAL means the Office of Procurement, Assistance and Logistics, which is an organizational component within the Office of the Secretary, HHS, and reports to the Assistant Secretary for Management and Budget.

Recipient means grantee or subgrantee. (See REWRITE 74.4(b).)

State means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State exclusive of local governments. However, for policies applicable to government hospitals and institutions of higher education, see REWRITE 74.4(c), ``Applicability of this part.''

Subgrant means an award of financial assistance in the form of money, or property in lieu of money, made under a grant by a grantee to an eligible subgrantee. The term includes financial assistance when provided by contract, but does not include procurements; nor does it include any form of assistance which is excluded from the definition of grant in this section.

Subgrantee means the government, nonprofit corporation, or other legal entity to which a subgrant is awarded and which is accountable to the grantee for the use of the funds provided. The subgrantee is the entire legal entity even if only a particular component of the entity is designated in the subgrant award document.

Terms of a grant or subgrant means all requirements of the grant or subgrant, whether in statute, regulations, the award document or elsewhere.

[45 FR 22576, Apr. 3, 1980, as amended at 47 FR 53013, Nov. 24, 1982]

REWRITE 74.4 Applicability of this part.

(a) General. (1) Except where inconsistent with Federal statutes, regulations, or other terms of a grant, this part applies to all HHS grants, other than the block grant programs identified in 45 CFR 96.1. However, unless expressly made applicable by the granting agency, this part shall not apply when the grantee is a Federal agency, foreign government or organization, international organization such as the United Nations, or individual.

(2) For grants which are subject to 45 CFR part 92, only the following provisions of this part apply:

(i) Section 74.62(a);

(ii) Section 74.173;

(iii) Section 74.174(b);

(iv) Section 74.304;

(v) Section 74.710; and

(vi) Section 74.715.

(b) Subgrants. For each substantive provision in this part, either the language of the provision itself or other text in the same subpart will indicate whether the provision affects only grants, only subgrants, or both. Use of the term ``recipient'' (as defined in §74.3) in a provision shall be taken as referring equally to grantees and subgrantees. Similarly, use of the term ``awarding party'' (as defined in §74.3) shall be taken as referring equally to granting agencies and to grantees awarding subgrants. However, unless expressly made applicable by the granting agency, this part need not be applied by the grantee to a subgrant if the subgrantee is a Federal agency, foreign government or organization, international organization such as the United Nations, or individual.

(c) Public institutions of higher education and hospitals. Grants and subgrants to institutions of higher education and hospitals operated by a government shall be subject only to provisions of this subpart that apply to nongovernmental organizations.

(d) For-profit organizations. The attention of for-profit organizations is directed to subpart AA of this part. The special provisions in that subpart for grants and subgrants to those organizations contain exceptions to other portions of this part.

[47 FR 53013, Nov. 24, 1982, as amended at 53 FR 8079, Mar. 11, 1988]

§74.5 Appeals.

In accordance with parts 16 and 75 of this title, grantees may appeal certain postaward administrative decisions made by HHS officials.

§74.6 Deviations.

(a) Except as provided in §74.7, a deviation is any exception to this part not required by Federal statute without allowance of agency discretion. A deviation may be either:

(1) Use of any policy, procedure, form, standard, or grant or subgrant term which is inconsistent with an applicable provision of this part, or

(2) Failure to use any applicable policy, procedure, form, standard, or grant or subgrant term which is required by this part.

(b) In order to maintain uniformity to the greatest extent feasible, deviations shall be kept to a minimum. A deviation, whether proposed by an applicant, a recipient, or an official of the granting agency, may be authorized only when it is necessary to meet programmatic objectives, or to conserve grant funds, or when it is otherwise essential in the public interest.

(c) Except as provided in paragraph (d) of this section, a deviation from this part may be made only when authorized by both:

(1) The head of the granting agency or other officials if designated in or pursuant to formal deviation control procedures established by the agency, and

(2) OPAL.

(d) Deviations from subpart Q of this part and appendixes C, D, E, and F to this part in individual cases (i.e., where only a single grant or subgrant is involved) shall not require OPAL approval.

[45 FR 22576, Apr. 3, 1980, as amended at 47 FR 53013, Nov. 24, 1982]

§74.7 Special grant or subgrant conditions.

(a) Without regard to the deviation control procedures of §74.6, special grant conditions more restrictive than those prescribed in this part 74 may be imposed as needed when the granting agency has determined that the grantee:

(1) Is financially unstable,

(2) Has a history of poor performance, or

(3) Has a management system which does not meet the standards of this part.

(b) When special conditions are imposed under paragraph (a) of this section, the grantee will be notified in writing:

(1) Why the special conditions were imposed and

(2) What corrective action is needed.

Furthermore, in accordance with OMB Circulars A - 102 and A - 110, OMB and other Federal agencies in a granting relationship with the grantee will be provided copies of the notice to the grantee.

(c) Grantees may apply the provisions of paragraphs (a) and (b) of this section to their subgrantees. Whenever they do so, a copy of the notice to the subgrantee shall be furnished to the granting agency.

Subpart B -- Cash Depositories

§74.10 Physical segregation and eligibility.

Except as provided in §74.11, awarding parties shall not impose grant or subgrant terms which:

(a) Require the recipient to use a separate bank account for the deposit of grant or subgrant funds, or

(b) Establish any eligibility requirements for banks or other financial institutions in which recipients deposit grant or subgrant funds.

§74.11 Checks-paid basis letter of credit.

A separate bank account shall be used when payments under letter of credit are made on a ``checks-paid'' basis. A checks-paid basis letter of credit is one under which funds are not drawn until the recipient's checks have been presented to its bank for payment. (See subpart K for definition of ``letter of credit.'')

§74.12 Minority-owned banks.

Consistent with the national goal of expanding opportunities for minority business enterprises, grantees and subgrantees are encouraged to use minority-owned banks. Upon request, OPAL will furnish a list of minority-owned banks.

[45 FR 22576, Apr. 3, 1980, as amended at 47 FR 53013, Nov. 24, 1982]

Subpart C -- Bonding and Insurance

§74.15 General.

In administering grants and subgrants, recipients shall observe their regular requirements and practices with respect to bonding and insurance. No additional bonding and insurance requirements, including fidelity bonds, shall be imposed by the terms of the grant or subgrant except as provided in §§74.16 through 74.18.

§74.16 Construction and facility improvement.

(a) Scope of this section. This section covers requirements for bid guarantees, performance bonds, and payments bonds when the recipient will contract for construction or facility improvement (including alterations and renovations of real property) under a grant or subgrant.

(b) Definitions. (1) Bid guarantee means a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder will, if its bid is accepted, execute the required contractual documents within the time specified.

(2) Performance bond means a bond executed in connection with a contract to secure fulfillment of all the contractor's obligations under the contract.

(3) Payment bond means a bond executed in connection with a contract to assure payment as required by law of all persons supplying labor and material in the execution of the work provided for in the contract.

(c) Bids and contacts of $100,000 or less. The recipient shall follow its own requirements and practices relating to bid guarantees, performance bonds, and payment bonds.

(d) Bids and contracts exceeding $100,000. The recipient may follow its own regular policy and requirements if the HHS granting agency has determined that the Federal Government's interest will be adequately protected. If this determination has not been made, the minimum requirements shall be as follows:

(1) A bid guarantee from each bidder equivalent to 5 percent of the bid price;

(2) A performance bond on the part of the contractor for 100 percent of the contract price; and

(3) A payment bond on the part of the contractor for 100 percent of the contract price.

§74.17 Fidelity bonds.

(a) If the grantee is not a government, the granting agency may require it to carry adequate fidelity bond coverage where the absence of coverage for the grant-supported activity is considered as creating an unacceptable risk.

(b) If the subgrantee is not a government, the granting agency or the grantee may require that it carry adequate fidelity bond coverage where the absence of coverage for the subgrant-supported activity is considered as creating an unacceptable risk.

(c) A fidelity bond is a bond indemnifying the recipient against losses resulting from the fraud or lack of integrity, honesty or fidelity of one or more employees, officers or other persons holding a position of trust.

§74.18 Source of bonds.

Any bonds required under §74.16(d)(1) through (3) or 74.17 shall be obtained from companies holding certificates of authority as acceptable sureties (31 CFR part 223). A list of these companies is published annually by the Department of the Treasury in its Circular 570.

Subpart D -- Retention and Access Requirements for Records

§74.20 Applicability.

(a) This subpart applies to all financial and programmatic records, supporting documents, statistical records, and other records of recipients, which are:

(1) Required to be maintained by the terms of an HHS grant, or

(2) Otherwise reasonably considered as pertinent to an HHS grant.

(b) This subpart does not apply to the records of contractors and subcontractors under grants and subgrants. For a requirement to place a provision concerning those records in certain kinds of contracts, see subpart P and appendices G and H of this part.

[45 FR 37667, June 3, 1980]

§74.21 Length of retention period.

(a) Except as provided in paragraphs (b) and (c) of this section, records shall be retained for 3-years from the starting date specified in §74.22.

(b) If any litigation, claim, negotiation, audit or other action involving the records has been started before the expiration of the 3-year period, the records shall be retained until completion of the action and resolution of all issues which arise from it, or until the end of the regular 3-year period, whichever is later.

(c) In order to avoid duplicate recordkeeping, awarding parties may make special arrangements with recipients to retain any records which are continuously needed for joint use. The awarding party will request transfer of records to its custody when it determines that the records possess long-term retention value. When the records are transferred to or maintained by the awarding party the 3-year retention requirement is not applicable to the recipient.

§74.22 Starting date of retention period.

(a) General. (1) Where HHS grant support is continued or renewed at annual or other intervals, the retention period for the records of each funding period starts on the day the grantee submits to HHS its single or last expenditure report for that period. However, if HHS grant support is continued or renewed quarterly, the retention period for each year's records starts on the day the grantee submits to HHS its expenditure report for the last quarter of the Federal fiscal year. In all other cases, the retention period starts on the day the grantee submits its final expenditure report to HHS. If an expenditure report has been waived, the retention period starts on

the day the report would have been due. ``Expenditure report'' is defined in §74.3.

(2) Exceptions to this paragraph are contained in paragraphs (b) through (d) of this section.

(b) Equipment records. The retention period for the equipment records required by §74.140(a) starts from the date of the equipment's disposition (§74.139) or replacement (§74.138) or transfer at the direction of the awarding party (§74.136).

(c) Records for income transactions after grant or subgrant support. (1) In some cases an HHS requirement concerning the disposition of program income, as defined in subpart F of this part, will be satisfied by applying the income to costs incurred after expiration or termination of grant or subgrant support for the activity giving rise to the income. In such a case, the retention period for the records pertaining to the costs starts from the end of the recipient's fiscal year in which the costs are incurred.

(2) In some cases, there may be an HHS requirement concerning the disposition of copyright royalties or other program income which is earned after expiration or termination of grant or subgrant support. Where there is such a requirement, the retention period for the records pertaining to the earning of the income starts from the end of the recipient's fiscal year in which the income is earned. (See Subpart F of this part.)

(d) Indirect cost rate proposals, cost allocation plans, etc. -- (1) Applicability. This paragraph applies to the following types of documents, and their supporting records:

(i) Indirect cost rate computations or proposals;

(ii) Cost allocation plans under Appendix C to this part;

(iii) Hospital patient care rate computations or proposals; and

(iv) Any similar accounting computations of the rate at which a particular group of costs is chargeable (such as computer usage chargeback rates or composite fringe benefit rates).

(2) If submitted for negotiation. If the proposal, plan, or other computation is required to be submitted to the Federal Government (or to the grantee) to form the basis for negotiation of the rate, then the 3-year retention period for its supporting records starts from the date of such submission.

(3) If not submitted for negotiation. If the proposal, plan, or other computation is not required to be submitted to the Federal Government (or to the grantee) for negotiation purposes, then the 3-year retention period for the proposal, plan, or computation and its supporting records starts from the

end of the fiscal year (or other accounting period) covered by the proposal, plan, or other computation.

§74.23 Substitution of microfilm.

Copies made by microfilming, photocopying, or similar methods may be substituted for the original records.

§74.24 Access to records.

(a) Records of grantees. HHS and the Comptroller General of the United States, or any of their authorized representatives, shall have the right of access to any books, documents, papers, or other records of the grantee which are pertinent to the HHS grant, in order to make audit, examination, excerpts, and transcripts.

(b) Records of subgrantees. HHS, the Comptroller General of the United States, and the grantee, or any of their authorized representatives, shall have the right of access to any books, documents, papers, or other records of the subgrantee which are pertinent to the HHS grant, in order to make audit, examination, excerpts, and transcripts.

(c) [Reserved]

(d) Expiration of right of access. The rights of access in this section shall not be limited to the required retention period but shall last as long as the records are retained.

[45 FR 22576, Apr. 3, 1980, as amended at 45 FR 37667, June 3, 1980]

§74.25 Restrictions on public access.

Unless required by Federal statutes, awarding parties may not impose grant or subgrant terms which limit public access to records covered by this subpart except after a determination by the granting agency that the records must be kept confidential and would have been excepted from disclosure under HHS's ``Freedom of Information'' regulation (Part 5 of this title) if the records had belonged to HHS. This section does not require recipients to permit public access to their records.

[45 FR 22576, Apr. 3, 1980, as amended at 45 FR 37667, June 3, 1980]

Subpart E -- Waiver of Single State Agency Requirements

§74.30 Policy.

Requests to HHS from Governors, or other duly constituted State authorities, for waiver of single State agency requirements in accordance with section 204 of the Intergovernmental Cooperation Act of 1968 will be given expeditious handling. Whenever possible, such requests will be granted.

Subpart F -- Grant-Related Income

§74.40 Scope of subpart.

This subpart contains policies and requirements relating to (a) program income and (b) interest and other investment income earned on advances of grant funds.

§74.41 Meaning of program income.

(a) Except as explained in paragraphs (b) and (c) of this section, program income means gross income earned by a recipient from activities part or all of the cost of which is either borne as a direct cost by a grant or counted as a direct cost towards meeting a cost sharing or matching requirement of a grant. It includes but is not limited to such income in the form of fees for services performed during the grant or subgrant period, proceeds from sale of tangible personal or real property, usage or rental fees, and patent or copyright royalties. If income meets this definition, it shall be considered program income regardless of the method used to calculate the amount paid to the recipient -- whether, for example, by a cost-reimbursement method or fixed price arrangement. Nor will the fact that the income is earned by the recipient from a Federal procurement contract or from a procurement contract under a Federal grant awarded to another party affect the income's classification as program income.

(b) For research grants that are subject to an institutional cost-sharing agreement, income shall be considered program income only if it is earned from an activity part or all of the cost of which is borne as a direct cost by the Federal grant funds. An institutional cost-sharing agreement is one entered into between HHS and a grantee covering all of HHS's research project grants to the grantee in the aggregate.

(c) The following shall not be considered program income:

(1) Revenues raised by a government recipient under its governing powers, such as taxes, special assessments, levies, and fines. (However, the receipt and expenditure of such revenues shall be recorded as a part of grant or subgrant project transactions when such revenues are specifically earmarked for the project in accordance with the terms of the grant or subgrant.)

(2) Tuition and related fees received by an institution of higher education for a regularly offered course taught by an employee performing under a grant or subgrant.

(d) For the purposes of this subpart, program income is divided into several categories. Each category is treated in a separate section of this subpart.

§74.42 General program income.

(a) Definition. General program income means all program income accruing to a grantee during the period of grant support or to a subgrantee during the period of subgrant support, other than the special categories of such income treated in §§74.43 through 74.45.

(b) Use. (1) General program income shall be retained by the recipient and used in accordance with one or a combination of the alternatives in paragraphs (c), (d), and (e) of this section, as follows: The alternative in paragraph (c) of this section may always be used by recipients and must be used if neither of the other two alternatives is permitted by the terms of the grant. The alternatives in paragraph (d) or (e) may be used only if expressly permitted by the terms of the grant. In specifying alternatives that may be used, the terms of the grant may distinguish between income earned by the grantee and income earned by subgrantees and between the sources, kinds, or amounts of income.

(2) The terms of a subgrant may restrict the use of general program income earned by the subgrantee to only one or some of the alternatives permitted by the terms of the grant, but the alternative in paragraph (c) of this section shall always be permitted.

(c) Deduction alternative. (1) Under this alternative, the income is used for allowable costs of the project or program. If there is a cost-sharing or matching requirement, costs borne by the income may not count toward satisfying that requirement. Therefore, the maximum percentage of Federal participation is applied to the net amount determined by deducting the income from total allowable costs and third-party in-kind contributions. The income shall be used for current costs unless the granting agency authorizes deferral to a later period.

(2) To illustrate this alternative, assume a project in which the grantee incurs $100,000 of allowable costs and receives no third-party in-kind contributions. If the grantee earns $10,000 in general program income and this alternative applies, that $10,000 must be deducted from the $100,000 before applying the maximum percentage of Federal participation. If that percentage is 90 percent, the most that could be paid to the grantee would therefore be $81,000 (90 percent times $90,000).

(d) Cost-sharing or matching alternative. (1) Under this alternative, the income is used for allowable costs of the project or program but, in this case, the costs borne by the income may count toward satisfying a cost-sharing or matching requirement. Therefore, the maximum percentage of Federal participation is applied to total allowable costs and third-party in-kind contributions. The income shall be used for current costs unless the granting agency authorizes deferral to a later period.

(2) To illustrate this alternative, assume the same situation as in paragraph (c)(2) of this section. Under this alternative, the 90 percent

maximum pecentage of participation would be applied to the full $100,000, and $90,000 could therefore be paid to the grantee. (It should be noted that if $20,000 of general program income is earned, only $80,000 could be paid, since a grant cannot pay for costs which have been borne by general program income.)

(e) Additional costs alternative. Under this alternative, the income is used for costs which are in addition to the allowable costs of the project or program but which nevertheless further the objectives of the Federal statute under which the grant was made. Provided that the costs borne by the income further the broad objectives of that statute, they need not be of a kind that would be permissible as charges to Federal funds.

Examples of purposes for which the income may be used are:

(1) Expanding the project or program.

(2) Continuing the project or program after grant or subgrant support ends.

(3) Supporting other projects or programs that further the broad objectives of the statute.

(4) Obtaining equipment or other assets needed for the project or program or for other activities that further the statute's objectives.

§74.43 Program income -- proceeds from sale of real property and from sale of equipment and supplies acquired for use.

The following kinds of program income shall be governed by Subpart O of this part:

(a) Proceeds from the sale of real property purchased or constructed under a grant or subgrant.

(b) Proceeds from the sale of equipment and supplies fabricated or purchased under a grant or subgrant and intended primarily for use in the grant- or subgrant-supported project or program rather than for sale or rental.

§74.44 Program income -- royalties and other income earned from a copyrighted work.

(a) This section applies to royalties, license fees, and other income earned by a recipient from a copyrighted work developed under the grant or subgrant. Income of that kind is covered by this section whether a third party or the recipient itself acts as the publisher, seller, exhibitor, or performer of the copyrighted work. In some cases the recipient incurs costs to earn the income but does not charge these costs to HHS grant funds, to required cost-sharing or matching funds, or to other program income. Costs of

that kind may be deducted from the gross income in order to determine how much must be treated as program income.

(b) The terms of the grant govern the disposition of income subject to this section. If the terms do not treat this kind of income, there are no HHS requirements governing the disposition. A grantee is not prohibited from imposing requirements of its own on the disposition of this kind of income which is earned by its subgrantees provided those requirements are in addition to and not inconsistent with any requirements imposed by the terms of the grant.

§74.45 Program income -- royalties or equivalent income earned from patents or from inventions.

Disposition of royalties or equivalent income earned on patents or inventions arising out of activities assisted by a grant or subgrant shall be governed by determinations made or agreements entered into under HHS's patent regulations. (See Parts 6 and 8 of this title.) If the determination or agreement does not provide for the disposition of the royalties or equivalent income, the disposition shall be in accordance with the recipient's own policies.

§74.46 Program income -- income after grant or subgrant support not otherwise treated.

(a) This section applies to program income not treated elsewhere in this part which arises from or is attributable to an activity while supported by a grant or subgrant but which does not accrue until after the period of grant or subgrant support. An example is proceeds from the sale or rental of a residual inventory of merchandise fabricated or purchased by a grant-supported workshop during the period of support.

(b) The terms of the grant govern the disposition of income subject to this section. If the terms do not treat this kind of income, there are no HHS requirements governing the disposition. A grantee is not prohibited from imposing requirements of its own on the disposition of this kind of income which is earned by its subgrantees provided those requirements are in addition to and not inconsistent with any requirements imposed by the terms of the grant.

§74.47 Interest earned on advances of grant funds.

(a) Except when exempted by Federal statute (see paragraph (b) of this section for the principal exemption), grantees shall remit to the Federal Government any interest or other investment income earned on advances of HHS grant funds. This includes any interest or investment income earned by subgrantees and cost-type contractors on advances to them that are attributable to advances of HHS grant funds to the grantee. Unless the grantee receives other instructions from the responsible HHS official, the

grantee shall remit the amount due by check or money order payable to the Department of Health and Human Services.

(b) In accordance with the Intergovernmental Cooperation Act of 1968 (Pub. L. 90 - 577), States, as defined in the act, shall not be accountable to the Federal Government for interest or investment income earned by the State itself, or by its subgrantees, where this income is attributable to grants-in-aid, as defined in the act (42 U.S.C. 4213).1 (FOOTNOTE)

(FOOTNOTE) 1State is defined in the Act to include any agency or instrumentality of a State, and the definition does not exclude a hospital or institution of higher education which is such an agency or instrumentality. Grant-in-aid is defined in the Act to exclude payments under research and development contracts or grants which are awarded directly and on similar terms to all qualifying organizations, whether public or private. (42 U.S.C. 4201)

(c) Recipients are cautioned that they are subject to the provisions in §74.61(e) for minimizing the time between the transfer of advances and their disbursement. Those provisions apply even if there is no accountability to the Federal Government for interest or other investment income earned on the advances.

Subpart G -- Cost Sharing or Matching

§74.50 Scope of subpart.

(a) This subpart contains rules for satisfying Federal requirements for cost sharing or matching. These rules apply whether the cost sharing or matching is required by Federal statute or by other terms of the grant.

(b) HHS and a grantee may enter into an institutional cost-sharing agreement covering all of HHS's research project grants to that grantee in the aggregate. Except as provided by the institutional cost-sharing agreement, this subpart applies to the satisfaction of the grantee's obligation under the agreement, as well as to the satisfaction of cost-sharing or matching requirements that apply only to a single grant.

§74.51 Definitions.

For purposes of this subpart:

Cost sharing or matching means the value of third-party in-kind contributions and that portion of the costs of a grant-supported project or program not borne by the Federal Government.

Equipment has the same meaning given to that term in §74.132, except that instead of acquisition cost, the words market value at the time of donation shall be substituted.

Supplies means all tangible personal property other than equipment as defined in this section.

Third-party in-kind contributions means property or services which benefit a grant-supported project or program and which are contributed by non-Federal third parties without charge to the grantee, the subgrantee, or a cost-type contractor under the grant or subgrant.

§74.52 Basic rule: Costs and contributions acceptable.

With the qualifications and exceptions listed in §74.53, a cost-sharing or matching requirement may be satisfied by either or both of the following:

(a) Allowable costs incurred by the grantee, the subgrantee, or a cost-type contractor under the grant or subgrant. This includes allowable costs borne by non-Federal grants or by other cash donations from non-Federal third parties.

(b) The value of third-party in-kind contributions applicable to the period to which the cost-sharing or matching requirement applies.

§74.53 Qualifications and exceptions.

(a) Costs borne by other Federal grants. (1) Except as provided by Federal statute, a cost-sharing or matching requirement may not be met by costs borne by another Federal grant. This prohibition does not apply to costs borne by general program income earned from a contract awarded under another Federal grant.

(2) For the purposes of this part, general revenue sharing funds under 31 U.S.C. 1221 are not considered a Federal grant. Therefore, in the absence of any provision of Federal statute to the contrary, allowable costs borne by these funds may count towards satisfying a cost-sharing or matching requirement.

(b) Costs or contributions counted towards other Federal cost-sharing requirements. Neither costs nor the values of third-party in-kind contributions may count towards satisfying a cost-sharing or matching requirement of an HHS grant if they have been or will be counted towards satisfying a cost-sharing or matching requirement of another Federal grant, a Federal procurement contract, or any other award of Federal funds.

(c) Costs financed by general program income. Costs financed by general program income, as defined in §74.42, shall not count towards satisfying a cost-sharing or matching requirement of the HHS grant supporting

the activity giving rise to the income unless the terms of the grant expressly permit the income to be used for cost sharing or matching. (This is the alternative for use of general program income described in §74.42(d).)

(d) Records. Costs and third-party in-kind contributions counting towards satisfying a cost-sharing or matching requirement must be verifiable from the records of recipients or cost-type contractors. These records must show how the value placed on third-party in-kind contributions was arrived at. To the extent feasible, volunteer services shall be supported by the same methods that the organization uses to support the allocability of its regular personnel costs.

(e) Special standards for third-party in-kind contributions. (1) Third-party in-kind contributions shall count towards satisfying a cost-sharing or matching requirement only where, if the party receiving the contributions were to pay for them, the payments would be allowable costs.

(2) A third-party in kind contribution shall not count as direct cost sharing or matching where, if the party receiving the contribution were to pay for it, the payment would be an indirect cost. Cost-sharing or matching credit for such contributions shall be given only if the recipient or contractor has established, along with its regular indirect cost rate, a special rate for allocating to individual projects or programs the value of the contributions. (Information on how to establish these rates can be obtained from the Division of Cost Allocation in any HHS regional office's Regional Administrative Support Center.)

(3) The values placed on third-party in-kind contributions for cost-sharing or matching purposes shall conform to the rules in the succeeding sections of this subpart. If a third-party in-kind contribution is of a type not treated in those sections, the value placed upon it shall be fair and reasonable.

§74.54 Valuation of donated services.

(a) Volunteer services. Unpaid services provided to a recipient by individuals shall be valued at rates consistent with those ordinarily paid for similar work in the recipient's organization. If the recipient does not have employees performing similar work, the rates shall be consistent with those ordinarily paid by other employers for similar work in the same labor market. In either case, a reasonable amount for fringe benefits may be included in the valuation.

(b) Employees of other organizations. When an employer other than a recipient or cost-type contractor furnishes free of charge the services of an employee in the employee's normal line of work, the services shall be valued at the employee's regular rate of pay exclusive of the employer's fringe benefits and overhead costs. If the services are in a different line of work, paragraph (a) of this section shall apply.

§74.55 Valuation of donated supplies and loaned equipment or space.

(a) If a third party donates supplies, the contribution shall be valued at the market value of the supplies at the time of donation.

(b) If a third party donates the use of equipment or space in a building but retains title, the contribution shall be valued at the fair rental rate of the equipment or space.

§74.56 Valuation of donated equipment, buildings, and land.

If a third party donates equipment, buildings, or land, and title passes to a recipient, the treatment of the donated property shall depend upon the purpose of the grant or subgrant, as follows:

(a) Awards for capital expenditures. If the purpose of the grant or subgrant is to assist the recipient in the acquisition of property, the market value of that property at the time of donation may be counted as cost sharing or matching.

(b) Other awards. If assisting in the acquisition of property is not the purpose of the grant or subgrant, the following rules apply:

(1) If approval is obtained from the awarding party, the market value at the time of donation of the donated equipment or buildings and the fair rental rate of the donated land may be counted as cost sharing or matching. In the case of a subgrant, the terms of the HHS grant may require that the approval be obtained from the granting agency as well as the grantee. In all cases, the approval may be given only if a purchase of the equipment or buildings or a purchase or rental of the land would be approved as an allowable direct cost.

(2) If approval is not obtained under paragraph (b)(1) of this section, no amount may be counted for donated land, and only depreciation or use allowances may be counted for donated equipment and buildings. The depreciation or use allowances for this property are not treated as third-party in-kind contributions. Instead, they are treated as costs incurred by the recipient. They are computed and allocated (usually as indirect costs) in accordance with the cost principles specified in subpart Q of this part, in the same way as depreciation or use allowances for purchased equipment and buildings. The amount of depreciation or use allowances for donated equipment and buildings is based on the property's market value at the time it was donated.

§74.57 Appraisal of real property.

In some cases under §§74.55 and 74.56, it will be necessary to establish the market value of land or a building or the fair rental rate of land or of space in a building. In these cases, the granting agency may require that the market value or fair rental rate be established by a

certified real property appraiser (or by a representative of the U.S. General Services Administration, if available) and that the value or rate be certified by a responsible official of the party to which the property or its use is donated. For subgrants, this requirement may also be imposed by the grantee.

Subpart H -- Standards for Grantee and Subgrantee Financial Management Systems and Audits

§74.60 Scope of subpart.

(a) This subpart contains standards for financial management systems and non-Federal audits of recipients.

(b) Awarding parties may not impose on recipients additional financial management standards or requirements concerning non-Federal audits. They may, however, provide recipients with suggestions and assistance on these subjects.

[45 FR 35329, May 27, 1980]

§74.61 Financial management standards.

Grantees and subgrantees shall meet the following standards for their grant and subgrant financial management systems.

(a) Financial reporting. Accurate, current, and complete disclosure of the financial results of each project or program shall be made in accordance with the financial reporting requirements of the grant or subgrant. The terms of grants and subgrants shall not require financial reporting on the accrual basis if the recipient's accounting system is maintained on the cash basis. When accrual reporting is statutorily required, a recipient whose accounting system is not maintained on that basis shall not be required to convert it to the accrual basis; the recipient may develop the accrual information through an analysis of the documentation on hand.

(b) Accounting records. Records which identify adequately the source and application of funds for grant- or subgrant-supported activities shall be maintained. These records shall contain information pertaining to grant or subgrant awards, authorizations, obligations, unobligated balances, assets, outlays, income, and, if the recipient is a government, liabilities.

(c) Internal control. Effective control and accountability shall be maintained for all grant or subgrant cash, real and personal property covered by subpart O of this part, and other assets. Recipients shall adequately safeguard all such property and shall assure that it is used solely for authorized purposes.

(d) Budgetary control. The actual and budgeted amounts for each grant or subgrant shall be compared. If appropriate or specifically required,

recipients shall relate financial information to performance or productivity data, including the production of unit cost information. If unit cost data are required, estimates based on available documentation will be accepted whenever possible.

(e) Advance payments. Procedures shall be established to minimize the time elapsing between the advance of Federal grant or subgrant funds and their disbursement by the recipient. When advances are made by a letter-of-credit method, the recipient shall make drawdowns as close as possible to the time of making disbursements. Grantees advancing cash to subgrantees shall conform substantially to the same standards of timing and amount as apply to advances by Federal agencies to grantees, including requirements for timely reporting of cash disbursements and balances. (See subpart K of this part.)

(f) Allowable costs. Procedures shall be established for determining the reasonableness, allowability, and allocability of costs in accordance with the applicable cost principles prescribed by subpart Q of this part and the terms of the grant.

(g) Source documentation. Accounting records shall be supported by source documentation such as cancelled checks, paid bills, payrolls, contract and subgrant award documents, etc.

(h) Audit resolution. Each recipient shall follow a systematic method to assure timely and appropriate resolution of audit findings and recommendations.

[45 FR 22576, Apr. 3, 1980, as amended at 45 FR 35329, May 27, 1980]

§74.62 Non-Federal audits.

(a) Governmental recipients -- (1) Fiscal periods of recipients beginning before January 1, 1985. Recipients that are governments shall comply with the requirements concerning non-Federal audits in Attachment P to OMB Circular A - 102 (October 1979) (see appendix G to part 74).

(2) Fiscal periods of recipients beginning on or after January 1, 1985. Recipients that are governments shall comply with OMB Circular A - 128. The Circular is codified verbatim in appendix J to this part.

(b) All other recipients -- (1) Fiscal periods of recipients beginning before January 1, 1990. Recipients that are not governments shall comply with the requirements concerning non-Federal audits in OMB Circular No. A - 110 (see appendix H to part 74).

(2) Fiscal periods of recipients beginning on or after January 1, 1990. Recipients that are not governments shall comply with OMB Circular A - 133. The Circular is codified verbatim in appendix I to this part.

(3) Hospitals. OMB Circular A - 133 exempts hospitals not affiliated with an institution of higher education. In determining whether or not this exemption applies, the term affiliated shall include all situations where:

(i) Either a hospital or an institution of higher education has an ownership interest in the other entity or some other party (other than a State or local unit of government) has an ownership interest in each of them;

(ii) An affiliation agreement exists; or

(iii) Federal research or training awards to a hospital or institution of higher education are performed in whole or in part in the facilities of, or involve the staff of, the other entity.

(c) Submission of audit reports. All copies of audit reports that a recipient is required under OMB Circular A - 128 or A - 133 to submit to HHS shall be addressed to the HHS Regional Inspector General for Audit Services responsible for the HHS region in which the recipient is located. The HHS Office of Inspector General will distribute copies as appropriate within the Department. Recipients, therefore, are not required to send their audit reports to any HHS officials other than the responsible Regional Inspector General for Audit Services.\1\ (FOOTNOTE)

(FOOTNOTE) \1\The Office of Inspector General is in the process of transferring this responsibility for recipients located in all regions to its Kansas City Office. Recipients in the New York, Philadelphia and Denver Regions should submit their reports to the Regional Inspector General for Audit Services, Kansas City, MO. Recipients in other regions will be advised directly by the Office of Audit Services when responsibility for their region is to be transferred.

[56 FR 8714, Mar. 1, 1991]

Subpart I -- Financial Reporting Requirements

§74.70 Scope and applicability of subpart.

(a) This subpart prescribes requirements and forms for grantees to report financial information to HHS, and to request grant payments when a letter of credit is not used.

(b) This subpart need not be applied by grantees in dealing with their subgrantees. However, grantees are encouraged not to impose on subgrantees more burdensome requirements than HHS imposes on grantees.

§74.71 Definitions.

As used in this subpart or in the forms identified by this subpart:

Accrued expenditures are the charges by grantee during a given period requiring the provision of funds for: (a) Goods and other tangible property received; (b) services performed by employees, contractors, subgrantees, and other payees; and (c) amounts becoming owed for which no current services or performance is required, such as annuities, insurance claims, and other benefit payments.

Accrued income is the sum of (a) earnings during a given period from services performed by the grantee and from goods and other tangible property delivered to purchasers, and (b) amounts becoming owed to the grantee for which no current services or performance is required by the grantee.

Federal funds authorized means the total amount of Federal funds obligated by the Federal Government and authorized for use by the grantee.

In-kind contributions means third-party in-kind contributions as defined in Subpart G of this part.

Obligations are the amounts of orders placed, contracts and subgrants awarded, services received, and similar transactions during a given period, which will require payment during the same or a future period.

Outlays are charges made to the grant project or program. Outlays may be reported on a cash or accrual basis.

Program income has the same meaning it has in Subpart F of this part.

Unobligated balance is the portion of the Federal funds authorized which has not been obligated by the grantee and is determined by deducting the grantee's cumulative obligations from the cumulative Federal funds authorized.

Unliquidated obligations, for reports prepared on a cash basis, are the amount of obligations incurred by the grantee that has not been paid. For reports prepared on an accrued expenditure basis, they are the amount of obligations incurred by the grantee for which an outlay has not been recorded.

§74.72 General.

(a) Except as provided in paragraphs (d) and (e) of this section, grantees shall use only the forms specified in §§74.73 through 74.76, and such supplementary or other forms as may from time to time be authorized by OPAL, for:

(1) Submitting grant financial reports to granting agencies, or

(2) Requesting advances or reimbursements when letters of credit are not used.

(b) Grantees shall follow all applicable standard instructions issued by OMB for use in connection with the forms specified in §§74.73 through 74.76. Granting agencies may issue substantive supplementary instructions only with the approval of OPAL. Granting agencies may shade out or instruct the grantee to disregard any line item that the granting agency finds unnecessary for its decision making purposes.

(c) Grantees will not be required to submit more than the original and two copies of forms required under this subpart.

(d) Granting agencies may provide computer outputs to grantees to expedite or contribute to the accuracy of reporting. Granting agencies may accept the required information from grantees in machine usable format or computer printouts instead of prescribed formats.

(e) When a granting agency has determined that a grantee's accounting system does not meet the standards for financial management systems contained in Subpart H of this part, it may require financial reports with more frequency or more detail (or both), upon written notice to the grantee (without regard to §74.7), until such time as the standards are met.

(f) HHS may waive any report required by this subpart if not needed.

(g) Granting agencies may extend the due date for any financial report upon receiving a justified request from the grantee.

[45 FR 22576, Apr. 3, 1980, as amended at 47 FR 53013, Nov. 24, 1982]

§74.73 Financial Status Report.

(a) Form. Grantees shall use Standard Form 269, Financial Status Report, to report the Status of funds for all nonconstruction grants.

(b) Accounting basis. Each grantee shall report program outlays and program income on the same accounting basis, i.e., cash or accrued expenditure (accrual), which it uses in its accounting system.

(c) Frequency. The granting agency may prescribe the frequency of the report for each project or program. However, the report shall not be required more frequently than quarterly except as provided in §§74.7 and 74.72(e). If the granting agency does not specify the frequency of the report, it shall be submitted annually. A final report shall be required upon expiration or termination of grant support.

(d) Due date. When reports are required on a quarterly or semiannual basis, they shall be due 30 days after the reporting period. When required on an annual basis, they shall be due 90 days after the grant year. Final reports shall be due 90 days after the expiration or termination of grant support.

§74.74 Federal Cash Transactions Report.

(a) Form. (1) For grants paid by letters of credit (or Treasury check advances) through any HHS payment office except the Departmental Federal Assistance Financing System (DFAFS), the grantee shall submit to the payment office Standard Form 272, Federal Cash Transactions Report, and when necessary, its continuation sheet, Standard Form 272a. For grants paid by DFAFS, the grantee shall submit DFAFS Report 27, Recipient Report of Expenditures, to DFAFS.

(2) These reports will be used by the HHS payment office to monitor cash advanced to grantees and to obtain disbursement or outlay information for each grant from grantees. The format of the report may be adapted as appropriate when reporting is to be accomplished with the assistance of automatic data processing equipment: Provided, That the information to be submitted is not changed in substance.

(b) Forecasts of Federal cash requirements. Forecasts of Federal cash requirements may be required in the ``Remarks'' section of the report.

(c) Cash in hands of secondary recipients. When considered necessary and feasible by the responsible HHS payment office, grantees may be required to report the amount of cash subadvances in excess of three days' needs in the hands of their subgrantees or contractors and to provide short narrative explanations of actions taken by the grantee to reduce the excess balances.

(d) Frequency and due date. Grantees shall submit the report no later than 15 working days following the end of each quarter. However, where a letter of credit authorizes advances at an annualized rate of one million dollars or more, the HHS payment office may require the report to be submitted within 15 working days following the end of each month.

§74.75 Request for Advance or Reimbursement.

(a)(1) Advance payments. Requests for Treasury check advance payments shall be submitted on Standard Form 270, Request for Advance or Reimbursement. (This form is not used for drawdowns under a letter of credit or when Treasury check advance payments are made to the grantee automatically on a predetermined basis.)

(2) Reimbursements. Requests for reimbursement under non-construction grants shall also be submitted on Standard Form 270. (For reimbursement requests under construction grants, see §74.76(a).)

(b) The frequency for submitting payment requests is treated in §74.96.

§74.76 Outlay report and request for reimbursement for construction programs.

(a) Construction grants paid by reimbursement method. (1) Requests for reimbursement under construction grants shall be submitted on Standard Form 271, Outlay Report and Request for Reimbursement for Construction Programs. Granting agencies may, however, prescribe the Request for Advance or Reimbursement form specified in §74.75 instead of this form.

(2) The frequency for submitting reimbursement requests is treated in §74.96.

(b) Construction grants paid by letter of credit or Treasury check advance. (1) When a construction grant is paid by letter of credit or Treasury check advances, the grantee shall report its outlays to the granting agency using Standard Form 271, Outlay Report and Request for Reimbursement for Construction Programs. The granting agency will provide any necessary special instruction. However, frequency and due date shall be governed by §74.73(c) and (d).

(2) When a construction grant is paid by Treasury check advances based on periodic requests from the grantee, the advances shall be requested on the form specified in §74.75.

(3) The granting agency may substitute the Financial Status Report specified in §74.73 for the Outlay Report and Request for Reimbursement.

(c) Accounting basis. The accounting basis for the Outlay Report and Request for Reimbursement for Construction Programs shall be governed by §74.73(b).

Subpart J -- Monitoring and Reporting of Program Performance

§74.80 Scope of subpart.

This subpart sets forth the procedures for monitoring and reporting program performance of recipients. These procedures are designed to place reliance on recipients to manage the day-to-day operations of their grant- and subgrant-supported activities.

§74.81 Monitoring by recipients.

Recipients shall monitor the performance of grant- and subgrant-supported activities. They shall review each program, function, or activity to assure that adequate progress is being made towards achieving the goals of the grant or subgrant.

§74.82 Performance reports under nonconstruction grants.

(a) Where the granting agency determines that performance information sufficient to meet its programmatic needs will be available from subsequent applications, the granting agency will require the grantee to submit a performance report only upon expiration or termination of grant support. This

report will be due on the same date as the final financial Status Report unless waived by the granting agency. Note that the ``Application for Federal Assistance (Nonconstruction Programs)'' prescribed by subpart N of this part, when used to request continued support, provides information substantially equivalent to a performance report.

(b) Except as provided in paragraph (a) of this section, grantees shall submit annual performance reports unless the granting agency requires quarterly or semiannual reports. Annual reports shall be due 90 days after the grant year; quarterly or semiannual reports shall be due 30 days after the reporting period. A final performance report shall be due 90 days after the expiration or termination of grant support. Granting agencies may extend the due date for any performance report upon receiving a justified request from the grantee. In addition, granting agencies may waive the requirement for any performance report which is not needed.

(c) The content of performance reports shall conform to any instructions issued by the granting agency, including, to the extent appropriate to the particular grant, a brief presentation of the following for each program, function, or activity involved:

(1) A comparison of actual accomplishments to the goals established for the period. Where the output of the project or program can be readily expressed in numbers, a computation of the cost per unit of output may be required if that information will be useful.

(2) The reasons for slippage if established goals were not met.

(3) Other pertinent information including, when appropriate, analysis and explanation of unexpectedly high overall or unit costs.

(d) Grantees will not be required to submit more than the original and two copies of performance reports.

(e) Grantees shall adhere to the standards in paragraphs (a) through (d) of this section in prescribing performance reporting requirements for subgrantees.

§74.83 Performance reports under construction grants.

In general, awarding parties rely heavily on on-site technical inspection and certified percentage-of-completion data to keep themselves informed as to progress under construction grants and subgrants. Formal performance reports to supplement those sources of information shall be required only if considered necessary by the awarding party, and in no case more frequently than quarterly.

§74.84 Significant developments between scheduled reporting dates.

Between the scheduled performance reporting dates, events may occur which have significant impact upon the grant- or subgrant-supported activity. In such cases, the recipient shall inform the awarding party as soon as the following types of conditions become known:

(a) Problems, delays, or adverse conditions which will materially impair the ability to attain the objective of the award. This disclosure shall be accompanied by a statement of the action taken, or contemplated, and any assistance needed to resolve the situation.

(b) Favorable developments which enable meeting time schedules and goals sooner or at less cost than anticipated or producing more beneficial results than originally projected.

§74.85 Site visits.

Site visits may be made as necessary by representatives of HHS to:

(a) Review program accomplishments and management control systems.

(b) Provide such technical assistance as may be required.

Subpart K -- Grant and Subgrant Payment Requirements

§74.90 Scope of subpart.

This subpart prescribes the basic standard and the methods under which HHS will make grant payments to grantees, and grantees will make subgrant payments to their subgrantees.

§74.91 Definitions.

As used in this subpart:

Advance by Treasury check is a payment made by a Treasury check to a grantee, upon its periodic request or through the use of predetermined payment schedules, before payments are made by the grantee.

Letter of credit is an instrument certified by an authorized official which authorizes a recipient to draw funds needed for immediate disbursement in accordance with Treasury Circular No. 1075.

Percentage of completion method refers to a system under which payments are made for construction work according to the percentage of completion of the work, rather than to the grantee's rate of disbursements.

§74.92 Basic standard.

(a) Methods and procedures for making payments to recipients shall minimize the time elapsing between the transfer of funds and the recipient's disbursements.

(b) Except as provided in §74.47(b), public and private nonprofit institutions of higher education, public and private nonprofit hospitals, and other private nonprofit grantees shall maintain advances of Federal funds in interest bearing accounts. Interest earned on Federal advances deposited in such accounts shall be remitted promptly, but at least quarterly, to the Federal agencies that provided the funds. Interest amounts up to $100 per recipient fiscal year may be retained by the recipient for administrative expense. (The $100 pertains to the total interest earned on all Federal advances.)

[45 FR 22576, Apr. 3, 1980, as amended at 52 FR 33240, Sept. 2, 1987]

§74.93 Payment methods under nonconstruction grants.

(a) Letters of credit will be used to pay HHS grantees when all of the following conditions exist:

(1) There is or will be a continuing relationship between the grantee and the HHS payment office for at least a year and the total amount of advances to be received from the HHS payment office is $120,000 or more per year,

(2) The grantee has maintained, or demonstrated to HHS the willingness and ability to maintain, procedures that minimize the time elapsing between the transfer of funds from the Treasury and their disbursement by the grantee, and

(3) The grantee's financial management system meets the standards for fund control and accountability in subpart H of this part.

(b) Advances by Treasury check will be used, in accordance with Treasury Circular No. 1075, when the grantee does not meet the requirements in paragraph (a)(1) of this section but does meet the requirements in paragraphs (a) (2) and (3) of this section.

(c) Reimbursement by Treasury check will be preferred method when the requirements of either paragraph (a)(2) or paragraph (a)(3) of this section are not met. This method may also be used when the major portion of the program is accomplished through private market financing or Federal loans, and the Federal grant assistance constitutes a minor portion of the program.

§74.94 Payment methods under construction grants.

(a) Reimbursement by Treasury check shall be the preferred method when the grantee does not meet the requirements specified in §74.93(a) (2) or (3), and may be used for any HHS construction grant unless HHS has entered

into an agreement with the grantee to use a letter of credit for all HHS grants, including construction grants.

(b) When the reimbursement by Treasury check method is not used, §74.93 (a) and (b) shall apply to the construction grant. Implementing procedures under §74.93 (a) and (b) will be insofar as possible the same for construction grants as for nonconstruction grants awarded to the same grantee.

(c) HHS will not use the percentage of completion method to pay its construction grants. The grantee may use that method to pay its construction contractor, but if it does, HHS's payments to the grantee will nevertheless be based on the grantee's actual rate of disbursements.

§74.95 Withholding of payments.

(a) Unless otherwise required by Federal statute, payments for proper charges incurred by grantees will not be withheld unless (1) the grantee has failed to comply with Federal reporting requirements or (2) the grant is suspended pursuant to §74.114 or (3) the grantee owes money to the United States and collection of the debt by withholding grant payments will not impair the accomplishment of the objectives of any grant program sponsored by the United States.

(b) Cash withheld for failure to comply with reporting requirements but without suspension of the grant will be released to the grantee upon subsequent compliance. When a grant is suspended, payment adjustments will be made in accordance with §74.114. When a debt is to be collected, HHS may withhold payments or require appropriate accounting adjustments to recorded grant cash balances for which the grantee is accountable to the Federal Government, in order to liquidate the indebtedness.

§74.96 Requesting advances or reimbursements.

(a) If advances are made by Treasury check and the advances are not prescheduled, the grantee shall submit its requests for payment monthly. Less frequent requests are not permitted because they would result in advances covering excessive periods of time. The grantee shall not request advances in excess of the Federal share of reasonable estimates of its outlays for the month covered. The grantee shall make these estimates on a cash basis, even if it uses an accrual accounting system.

(b) If payments are made through reimbursement by Treasury check:

(1) The grantee may submit its requests for reimbursement monthly and may submit them more often if authorized. The grantee will be paid as promptly as possible, ordinarily within 30 days after receipt of a proper request for reimbursement.

(2) The grantee shall not request reimbursement for the Federal share of amounts withheld from contractors to ensure satisfactory completion of work until after it makes those payments. To meet this requirement, a grantee with an accural accounting system need not convert to cash basis accounting. It may bill in general on an accrued cost basis, handling these retained amounts as adjustments in the billing system.

(c) The forms for requesting advances or reimbursements are identified in subpart I of this part.

[45 FR 37667, June 3, 1980]

§74.97 Payments to subgrantees.

Grantees shall observe the requirements of this subpart in making (or withholding) payments to subgrantees, with the following exceptions:

(a) Advance payment by check may be used instead of letter of credit;

(b) The forms specified in subpart I of this part for requesting advances and reimbursements are not required to be used by subgrantees; and

(c) The reimbursement by check method may be used to pay any construction subgrant, whether or not HHS has agreed to use a letter of credit for all direct HHS grants to that same recipient.

Subpart L -- Programmatic Changes and Budget Revisions

§74.100 Scope and applicability of this subpart.

(a) Scope. This subpart deals with prior approval requirements for post-award programmatic changes and budget revisions by recipients.

(b) Exemption of mandatory grants. Sections 74.103 through 74.106 do not apply to programmatic changes or budget revisions made by grantees under State plan or other grants which the granting agency is required by law to award if the applicant meets all applicable requirements for entitlement. (These are generally called ``mandatory'' or ``formula'' grants.)

(c) Exemption of certain subgrants. Sections 74.103 through 74.106 do not apply to subgrants from States to their local governments under a mandatory or formula grant, if the local government is not required to apply for the subgrant on a project basis. Generally, such exempt subgrants will occur under a State plan which provides for local administration of a State-wide program under State supervision.

§74.101 Relationship to cost principles.

The cost principles prescribed by subpart Q of this part contain requirements for prior approval of certain types of costs (see §74.177).

Except when waived, those requirements apply to all grants and subgrants even if §§74.103 through 74.106 do not.

[47 FR 53013, Nov. 24, 1982]

§74.102 Prior approval procedures.

(a) For grants. When requesting a prior approval required by this subpart, grantees shall address their requests to the responsible grants officer of the granting agency. Approvals shall not be valid unless they are in writing and signed by either the grants officer, the head of the granting agency, or the head of the granting agency's regional office.

(b) For subgrants. Grantees shall be responsible for reviewing requests from their subgrantees for the approvals required by this subpart and for giving or denying the approval. A grantee shall not approve any action which is inconsistent with the purpose or terms of the Federal grant. If an action by a subgrantee will result in a change in the overall grant project or budget requiring granting agency approval, the grantee shall obtain that approval before giving its approval to the subgrantee. Approvals shall not be valid unless they are in writing and signed by an authorized official of the grantee.

(c) Timing. Within 30 days from the date of receipt of a request for approval, the approval authority shall review the request and notify the recipient of its decision. If the request for approval is still under consideration at the end of 30 days, the approval authority shall inform the recipient in writing as to when to expect the decision.

§74.103 Programmatic changes.

(a) Scope. This section contains requirements for prior approval of departures, other than budget revisions, from approved project plans. In addition to the requirements in this section, awarding parties may require prior approval for other kinds of programmatic changes to an approved grant or subgrant project.

(b) Changes to project scope or objectives. The recipient shall obtain prior approval for any change to the scope or objectives of the approved project. (For construction projects, any material change in approved space utilization or functional layout shall be considered a change in scope.)

(c) Changes in key people. The recipient of a grant or subgrant for research (or any other kind of grant or subgrant if the terms of the award make this rule applicable) shall obtain prior approval:

(1) To continue the project during any continuous period of more than 3 months without the active direction of an approved project director or principal investigator; or

(2) To replace the project director or principal investigator (or any other persons named and expressly identified as key project people in the notice of grant or subgrant award) or to permit any such people to devote substantially less effort to the project than was anticipated when the grant or subgrant was awarded.

(d) Other programmatic changes. The following shall require prior approval except to the extent explicitly included in the project plan as approved by the awarding party at the time of award:

(1) Providing financial assistance to a third party by subgranting or any other means.

(2) Tranferring to a third party, by contracting or any other means, the actual performance of the substantive programmatic work. The term ``substantive programmatic work'' means activities which are central to carrying out the purpose of the project, and not merely incidental. Transfer of substantive programmatic work does not include purchase of supplies, materials, or equipment; acquisition of general or incidental support services; obtaining advice; or transfer of activities whose cost is treated as an indirect cost.

(3) Providing medical care to individuals under research grants.

§74.104 Budgets generally.

(a) Definitions. In this subpart:

(1) ``Budget'' means the recipient's financial plan for carrying out the project or program.

(2) ``Approved budget'' means a budget (including any revised budget) which has been approved by the awarding party.

(b) Research project budgets. For research projects, approved budgets shall not include the recipient's share of project costs.

(c) Non-research project budgets. For non-research projects which involve cost sharing or matching, approved budgets shall ordinarily consist of a single set of figures covering total project cost (the sum of the awarding party's share and the recipient's share). However, the awarding party may specify that the recipient's share not be included in the approved budget. In no case, however, shall the approved budget be in the form of a separate set of figures for each share.

(d) Subdivision by programmatic segments. Some grants and subgrants encompass two or more programmatic segments (such as discrete programs, projects, functions, or types of activities). In these cases, the awarding party may require that the approved budget be subdivided to show the anticipated cost of each programmatic segment.

§74.105 Budget revisions -- nonconstruction projects.

(a) Except as provided in paragraph (b) of this section, the recipient of a grant or subgrant having an approved budget shall obtain prior approval for any budget revision which will:

(1) Involve transfer of amounts budgeted for indirect costs to absorb increases in direct costs, or

(2) Involve transfer of amounts previously budgeted for student support (tuition waivers, stipends, and other payments to or for trainees), or

(3) Result in a need for the award of additional funds, e.g., an increase in the base upon which indirect costs are calculated which will increase allocable indirect costs and result in a claim for a supplementary award.

(b) Any or all of the prior approval requirements in paragraph (a) of this section may be waived by the awarding party.

(c) Except as provided in §§74.107 and 74.177, other budget changes under nonconstruction grants do not require approval.

[45 FR 22576, Apr. 3, 1980, as amended at 47 FR 53013, Nov. 24, 1982]

§74.106 Budget revisions -- construction projects.

Unless provided otherwise by the terms of the grant or subgrant, revisions to construction project budgets do not require approval.

§74.107 Construction and nonconstruction work under the same grant or subgrant.

When a grant or subgrant provides support for both construction and nonconstruction work, the awarding party may require prior approval before any fund or budget transfers between the two types of work.

§74.108 Authorized funds exceeding needs.

The recipient shall notify the awarding party promptly whenever the amount of grant or subgrant authorized funds is expected to exceed needs by more than $5,000 or 5 percent of the grant or subgrant, whichever is greater. This notification will not be required under continuing grants or subgrants if the application for the next period's funding will include an estimate of what the unobligated balance of authorized funds will be at the end of the current period.

Subpart M -- Grant and Subgrant Closeout, Suspension, and Termination

§74.110 Definitions.

Grant closeout means the process by which a granting agency determines that all applicable administrative actions and all required work of the grant have been completed by the grantee and the granting agency.

Suspension of a grant means temporary withdrawal of the grantee's authority to obligate grant funds pending corrective action by the grantee or a decision to terminate the grant.

Termination of a grant means permanent withdrawal of the grantee's authority to obligate previously awarded grant funds before that authority would otherwise expire. It also means the voluntary relinquishment of that authority by the grantee. ``Termination'' does not include:

(a) Withdrawal of funds awarded on the basis of the grantee's underestimate of the unobligated balance in a prior period;

(b) Refusal by the granting agency to extend a grant or award additional funds (such as refusal to make a competing or noncompeting continuation, renewal, extension, or supplemental award);

(c) Withdrawal of the unobligated balance as of the expiration of a grant;

(d) Annulment, i.e., voiding, of a grant upon determination that the award was obtained fraudulently, or was otherwise illegal or invalid from inception.

§74.111 Closeout.

(a) Each grant shall be closed out as promptly as is feasible after expiration or termination.

(b) In closing out HHS grants, the following shall be observed:

(1) Upon request, HHS shall promptly pay the grantee for any allowable reimbursable costs not covered by previous payments.

(2) The grantee shall immediately refund or otherwise dispose of, in accordance with instructions from HHS, any unobligated balance of cash advanced to the grantee.

(3) The grantee shall submit, within 90 days of the date of expiration or termination, all financial, performance, and other reports required by the terms of the grant. HHS may extend the due date for any report upon receiving a justified request from the grantee, and may waive any report which is not needed.

(4) The granting agency shall make a settlement for any upward or downward adjustment of the Federal share of costs, to the extent called for by the terms of the grant.

(c)(1) The closeout of a grant does not affect the retention period for, or Federal rights of access to, grant records. See Subpart D of this part.

(2) If a grant is closed out without audit, the granting agency retains the right to disallow and recover an appropriate amount after fully considering any recommended disallowances resulting from an audit which may be conducted later.

(3) The closeout of a grant does not affect the grantee's responsibilities with respect to property under Subpart O of this part, or with respect to any program income for which the grantee is still accountable under Subpart F of this part.

§74.112 Amounts payable to the Federal Government.

For each grant, the following sums shall constitute a debt or debts owed by the grantee to the Federal Government, and shall, if not paid upon demand, be recovered from the grantee or its successor or assignees by set-off or other action as provided by law:

(a) Any grant funds paid to the grantee by the Federal Government in excess of the amount to which the grantee is finally determined to be entitled under the terms of the grant;

(b) Any interest or other investment income earned on advances of grant funds which is due the Federal Government pursuant to §74.47;

(c) Any royalties or other special classes of program income which, under the terms of the grant, are required to be remitted to the Federal Government (see Subpart F of this part);

(d) Any amounts due the Federal Government under Subpart O of this part; and

(e) Any other amounts finally determined to be due the Federal Government under the terms of the grant.

§74.113 Violation of terms.

(a) When a grantee has materially failed to comply with the terms of a grant, the granting agency may suspend the grant, in accordance with §74.114, terminate the grant for cause, as provided in §74.115, or take such other remedies as may be legally available and appropriate in the circumstances.

(b) If a project or program is supported over two or more funding periods, a grant may be suspended or terminated in the current period for failure to submit a report still due from a prior period.

§74.114 Suspension.

(a) When a grantee has materially failed to comply with the terms of a grant, the granting agency may, upon reasonable notice to the grantee, suspend the grant in whole or in part. The notice of suspension will state the reasons for the suspension, any corrective action required of the grantee, and the effective date. The suspension may be made effective at once if a delayed effective date would be unreasonable considering the granting agency's responsibilities to protect the Federal Government's interest. Suspensions shall remain in effect until the grantee has taken corrective action satisfactory to the granting agency, or given evidence satisfactory to the granting agency that such corrective action will be taken, or until the granting agency terminates the grant.

(b) New obligations incurred by the grantee during the suspension period will not be allowed unless the granting agency expressly authorizes them in the notice of suspension or an amendment to it. Necessary and otherwise allowable costs which the grantee could not reasonably avoid during the suspension period will be allowed if they result from obligations properly incurred by the grantee before the effective date of the suspension and not in anticipation of suspension or termination. At the discretion of the granting agency, third-party in-kind contributions applicable to the suspension period may be allowed in satisfaction of cost sharing or matching requirements.

(c) Appropriate adjustments to payments under the suspended grant will be made either by withholding subsequent payments or by not allowing the grantee credit for disbursements made in payment of unauthorized obligations incurred during the suspension period.

§74.115 Termination.

(a) Termination for cause. The granting agency may terminate any grant in whole, or in part, at any time before the date of expiration, whenever it determines that the grantee has materially failed to comply with the terms of the grant. The granting agency shall promptly notify the grantee in writing of the determination and the reasons for the termination, together with the effective date.

(b) Termination on other grounds. Except as provided in paragraph (a) of this section, grants may be terminated in whole or in part only as follows:

(1) By the granting agency with the consent of the grantee, in which case the two parties shall agree upon the termination conditions, including

the effective date and in the case of partial terminations, the portion to be terminated, or

(2) By the grantee, upon written notification to the granting agency, setting forth the reasons for such termination, the effective date, and in the case of partial terminations, the portion to be terminated. However, if, in the case of a partial termination, the granting agency determines that the remaining portion of the grant will not accomplish the purposes for which the grant was made, the granting agency may terminate the grant in its entirety under either paragraph (a) or paragraph (b)(1) of this section.

(c) Termination settlements. When a grant is terminated, the grantee shall not incur new obligations for the terminated portion after the effective date, and shall cancel as many outstanding obligations as possible. The granting agency shall allow full credit to the grantee for the Federal share of the noncancellable obligations properly incurred by the grantee prior to termination.

§74.116 Applicability to subgrants.

Grantees shall adhere to the same standards regarding closeout, suspension, and termination of subgrants as are prescribed in this subpart for granting agencies.

Subpart N -- Forms for Applying for Grants

§74.120 Scope of subpart.

(a) This subpart prescribes forms and instructions to be used by governmental organizations (except hospitals and institutions of higher education operated by a government) in applying to HHS for grants. This subpart is not applicable, however, to mandatory or formula grant programs which do not require applicants to apply to HHS for funds on a project basis.

(b) This subpart permits granting agencies to prescribe the form of applications by nongovernmental organizations (including hospitals and institutions of higher education operated by a government), but prescribes the use of a standard facesheet for certain of these applications.

(c) This subpart applies only to applications for grants, and is not required to be applied by grantees in dealing with applicants for subgrants. However, grantees are encouraged not to adopt more detailed or burdensome application requirements for subgrants.

§74.121 Authorized forms and instructions for governmental organizations.

(a) In applying to HHS for grants, governments shall use only the forms specified in §§74.122 through 74.126, and such supplementary or other

forms as may from time to time be prescribed by the granting agency with the approval of OPAL.

(b) Governments will not be required to submit more than the original and two copies of their applications.

(c) Governments shall follow all applicable standard instructions promulgated by OMB for use in connection with the forms specified in §§74.122 through 74.126. Granting agencies may specify and describe the programs, functions, or activities that will be used to plan, budget, and evaluate the work under a grant. Other supplementary instructions may be issued only with the approval of OPAL. For any form, the granting agency may shade out or instruct the applicant to disregard any line item that is not needed.

(d) When a government applies for additional funding (such as a continuation or supplemental award) or amends a previously submitted application, only the facesheet and any other affected pages need be submitted. Previously submitted pages whose information is still current need not be resubmitted.

[45 FR 22576, Apr. 3, 1980, as amended at 47 FR 53013, Nov. 24, 1982]

§74.122 Preapplications for Federal Assistance for governmental organizations.

(a) When a preapplication is submitted by a government, the preapplication for Federal assistance form prescribed by OMB Circular A - 102 shall be used. The purposes of preapplications shall be to:

(1) Establish communication between the applicant and the granting agency;

(2) Determine the applicant's eligibility;

(3) Determine how well the project can compete with similar applications from others in order to discourage proposals which have little or no chance for Federal funding before applicants incur significant expenditures for preparing an application.

(b) Preapplication shall be mandatory when the potential applicant is a government and the proposed project (1) is for construction, land acquisition, or land development, and (2) would require more than $100,000 of Federal funding. The granting agency may require preapplications regardless of the type of project and regardless of the estimated amount of Federal funding. In addition, any government may submit a preapplication even when not required by the granting agency.

§74.123 Notice of preapplication review action for governmental organizations.

The notice of preapplication review action form prescribed by Attachment M of OMB Circular No. A - 102 will be used by granting agencies to inform governmental applicants of the results of the review of the preapplications submitted to them. The granting agency will send a notice to the applicant ordinarily within 45 days of the receipt of the preapplication form. If the review cannot be made within 45 days, the applicant will be informed by letter as to when the review will be completed.

§74.124 Application for Federal assistance (nonconstruction programs) for governmental organizations.

The applicant for Federal assistance (nonconstruction programs) form prescribed by Attachment M of OMB Circular No. A - 102 shall be used by governments in applying for any grant to which this subpart is applicable except where a form specified in §74.125 or §74.126 is to be used.

§74.125 Application for Federal assistance (for construction programs) for governmental organizations.

The applicant for Federal assistance (for construction programs) form prescribed by Attachment M of OMB Circular No. A - 102 shall be used by governments in applying for any grant whose purpose is solely or primarily construction, land acquisition, or land development.

§74.126 Application for Federal assistance (short form) for governmental organizations.

The applicant for Federal assistance (short form) form prescribed by Attachment M of OMB Circular No. A - 102 shall be used by governments in applying for any single-purpose one-time grant of less than $10,000 not requiring clearinghouse review, an environmental impact statement, or the relocation of persons, businesses, or farms. Granting agencies may, at their discretion, authorize or prescribe this form for applications for larger amounts.

§74.127 Authorized forms and instructions for nongovernmental organizations.

Nongovernmental organizations shall use application forms and instructions prescribed by the granting agency, except that the facesheet of such applications shall be standard form 424 for grants under programs covered by Attachment A. part I, of OMB Circular No. A - 95.

Subpart O -- Property

General

§74.130 Scope and applicability of this subpart.

(a) Except as explained in paragraphs (c), (d), and (e) of this section this subpart applies to real property, equipment, and supplies acquired with grant support. To be considered acquired with grant support, some or all of the property's acquisition cost must be a direct cost under the grant, a subgrant, or a cost-type contract and must be either borne by grant funds or counted toward satisfying a grant cost-sharing or matching requirement.

(b) This subpart also deals with inventions, patents, and copyrights arising out of activities assisted by a grant or subgrant.

(c) This subpart does not apply to --

(1) Property for which only depreciation or use allowances are charged;

(2) Property donated entirely as a third-party in-kind contribution (as defined in §74.51); or

(3) Equipment or supplies acquired primarily for sale or rental rather than for use.

(d) Equipment or supplies acquired by a contractor under its contract are not subject to this subpart if, by the terms of the contract, title to the property vests in the contractor or another third party.

(e) For research grants that are subject to an institutional cost-sharing agreement (see §74.50(b)), real property, equipment, and supplies shall be subject to this subpart only if at least some part of the acquisition cost is borne as a direct cost by Federal grant funds.

[45 FR 22576, Apr. 3, 1980, as amended at 47 FR 53013, Nov. 24, 1982]

§74.131 Prohibition against additional requirements.

Recipients may follow their own property management policies and procedures: Provided, They observe the requirements of this subpart. Awarding parties may not impose on recipients property requirements (including property reporting requirements) not authorize by this subpart, unless specifically required by Federal statutes or Executive orders.

§74.132 Definitions.

As used in this subpart:

Acquisition of property includes purchase, construction, or fabrication of property, but does not include rental of property or alterations and renovations of real property.

Acquisition cost of an item of purchased equipment means the net invoice price of the equipment, including the cost of modifications, attachments, accessories, or auxiliary apparatus necessary to make the equipment usable for the purpose for which it was acquired. Other charges such as the cost of installation, transportation, taxes, duty or protective in-transit insurance shall be included in or excluded from the unit acquisition cost in accordance with the regular accounting practices of the organization purchasing the equipment. If the item is acquired by trading in another item and paying an additional amount, ``acquisition cost'' means the amount received for trade-in plus the additional outlay.

Amount received for trade-in of an item of equipment traded in for replacement equipment means the amount that would have been paid for the replacement equipment without a trade-in minus the amount paid with the trade-in. The term refers to the actual difference, not necessarily the trade-in value shown on an invoice.

Equipment means an article of tangible personal property that has a useful life of more than two years and an acquisition cost of $500 or more. Any recipient may use its own definition of equipment if its definition would at least include all items of equipment as defined here.

Personal property means property of any kind except real property. It may be tangible -- having physical existence, or intangible -- having no physical existence, such as patents, inventions, and copyrights.

Real property means land, including land improvements, structures and appurtenances thereto, but excluding movable machinery and equipment.

Replacement equipment means property acquired to take the place of other equipment. To qualify as replacement equipment, it must serve the same function as the equipment replaced and must be of the same nature or character, although not necessarily the same model, grade, or quality.

Supplies means all tangible personal property other than equipment.

[45 FR 22576, Apr. 3, 1980, as amended at 46 FR 30501, June 9, 1981]

§74.133 Title to real property, equipment, and supplies.

Subject to the obligations and conditions set forth in this subpart, title to real property, equipment, and supplies acquired under a grant or subgrant shall vest, upon acquisition, in the grantee or subgrantee respectively.

Real Property

§74.134 Real property.

Except as otherwise provided by Federal statutes, real property to which this subpart applies shall be subject to the following requirements, in addition to any other requirements imposed by the terms of the grant:

(a) Use. The property shall be used for the originally authorized purpose as long as needed for that purpose. When no longer so needed, approval of the granting agency may be requested to use the property for other purposes. Use for other purposes shall be limited to:

(1) Projects or programs supported by other Federal grants or assistance agreements.

(2) Activities not supported by other Federal grants or assistance agreements but having, nevertheless, purposes consistent with those of the legislation under which the original grant was made.

(b) Transfer of title. Approval may be requested from the granting agency to transfer title to an eligible third party for continued use for authorized purposes in accordance with paragraph (a) of this section. If approval is permissible under Federal statutes and is given, the terms of the transfer shall provide that the transferee shall assume all the rights and obligations of the transferor set forth in this subpart or in other terms of the grant or subgrant.

(c) Disposition. When the real property is no longer to be used as provided in paragraphs (a) and (b) of this section, the disposition instructions of the granting agency shall be followed. Those instructions will provide for one of the following alternatives:

(1) The property shall be sold and the Federal Government shall be paid an amount computed by multiplying the Federal share of the property (see §74.142) times the proceeds from sale (after deducting actual and reasonable selling and fix-up expenses, if any, from the sales proceeds). Proper sales procedures shall be used that provide for competition to the extent practicable and result in the highest possible return.

(2) The recipient shall have the option either of selling the property in accordance with paragraph (c)(1) of this section or of retaining title. If title is retained, the Federal Government shall be paid an amount computed by multiplying the market value of the property by the Federal share of the property.

(3) The recipient shall transfer the title to either the Federal Government or an eligible non-Federal party named by the granting agency. The grantee shall be entitled to be paid an amount computed by multiplying the market value of the property by the non-Federal share of the property. If the property belonged to a subgrantee, see §74.143 for subgrantee's share.

Equipment and Supplies

§74.135 Exemptions for equipment and supplies subject to certain statutes.

(a) Some Federal statutes, in certain circumstances, permit title to equipment or supplies acquired with grant funds to vest in the recipient without further obligation to the Federal Government or on such terms and conditions as deemed appropriate. An example of such a statute is the Federal Grant and Cooperative Agreement Act of 1977, Pub. L. 95 - 224, which provides this authority for equipment and supplies purchased with the funds of grants (and Federal contracts and cooperative agreements) for the conduct of basic or applied scientific research at nonprofit institutions of higher education or at nonprofit organizations whose primary purpose is the conduct of scientific research.

(b) If equipment is subject to a statute of the kind described in paragraph (a) of this section, it shall be exempt from the requirements in the remaining sections of this subpart. However, an item of such equipment having a unit acquisition cost of $1,000 or more shall be subject to §74.136, concerning rights to require transfer, and, while subject to such a right, to the rules on replacement in §74.138.

(c) If supplies are subject to a statute of the kind described in paragraph (a) of this section, they shall be exempt from all provisions of the remainder of this subpart which would otherwise apply.

§74.136 Rights to require transfer of equipment.

(a) HHS right. For items of equipment having a unit acquisition cost of $1,000 or more, the granting agency shall have the right to require transfer of the equipment (including title) to the Federal Government or to an eligible non-Federal party named by the granting agency. This right will normally be exercised by HHS granting agencies only if the project or program for which the equipment was acquired is transferred from one grantee to another. The right shall be subject to the following conditions:

(1) In order for the granting agency to exercise the right, a specific notice that it is exercising the right or considering doing so must be issued no later than the 120th day after the end of HHS grant support for the project or program for which the equipment was acquired. Furthermore:

(i) If the equipment is eligible for the exemptions in §74.135 and ceases to be needed for the project or program for which it was acquired while the project or program is still being performed by the recipient, the notice must have been received by the grantee while the equipment was still needed for that project or program.

(ii) If the equipment is not eligible for those exemptions, the notice must have been received by the grantee before other permissible disposition of the equipment took place in accordance with §74.139.

(2) If the right is exercised, the grantee shall be entitled to be paid any reasonable, resulting shipping or storage costs incurred, plus an amount computed by multiplying the market value of the equipment by the non-Federal share of the equipment. (See §§74.142 and 74.143.)

(b) Right of parties awarding subgrants. When a grantee awards a subgrant, it may reserve for itself a right similar to that in paragraph (a) of this section for items of equipment having a unit acquisition cost of $1,000 or more which are acquired under that subgrant. Without the approval of the granting agency, the right may be exercised only if the project or program for which the equipment was acquired is transferred to another subgrantee and only for the purpose of transferring the equipment to the new subgrantee for continued use in the project or program.

(c) Equipment lists. If at any time an awarding party is considering exercising its right to require transfer of equipment, it may require the recipient to furnish it a listing of all items of equipment that are subject to the right. This will enable the awarding party to determine which items, if any, should be transferred.

§74.137 Use of equipment.

(a) Basic rule. Equipment which has not been transferred under §74.136 shall be used by the recipient in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds. When no longer needed for the original project or program, the recipient shall use the equipment, if needed, in other projects or programs currently or previously sponsored by the Federal Government, in the following order of priority:

(1) Projects or programs currently or previously sponsored by the same granting agency.

(2) Projects or programs currently or previously sponsored by other Federal agencies.

(b) Shared use. If equipment is being used less than full time in the project or program for which it was originally acquired, the recipient shall make it available for use in other projects or programs currently or previously sponsored by the Federal Government: Provided, Such other use will not interfere with the work on the original project or program. First preference for such other use shall be given to other projects or programs sponsored by the same granting agency.

(c) Use by other recipients. When the recipient can no longer use the equipment as required by paragraph (a) of this section, it may voluntarily make the equipment available for use on projects or programs currently or previously sponsored by the Federal Government which the recipient is supporting through subgrants or through non-Federal grants. If the recipient is a subgrantee, it may also voluntarily make the equipment available for use

on projects or programs currently or previously sponsored by the Federal Government which are being conducted or supported by the grantee.

(d) Other uses. Unless the granting agency provides otherwise, while equipment is being used as described in the preceding paragraphs of this section, it may also be used part time for other purposes. However, use as described in those paragraphs shall be given priority over other uses.

§74.138 Replacement of equipment.

(a) Equipment may be exchanged for replacement equipment if needed. The replacement may take place either through trade-in or through sale and application of the proceeds to the acquisition cost of the replacement equipment. In either case, the transaction must be one which a prudent person would make in like circumstances.

(b) If an additional outlay to acquire the replacement equipment is charged as a direct cost to either Federal funds or required cost-sharing or matching under a Federal award, the replacement equipment shall be subject to whatever property requirements or exemptions are applicable to that award. If the award is a grant from HHS, the full acquisition cost of the replacement equipment shall determine which provisions of this subpart apply.

(c) For any replacement not covered by paragraph (b) of this section, the provisions of this subpart applicable to the equipment replaced shall carry over to the replacement equipment. However, none of the provisions of this subpart shall carry over if (1) the Federal share of the equipment replaced was 10 percent or less or (2) the product of that share times the amount received for trade-in or sale is $100 or less.

§74.139 Disposition of equipment.

When original or replacement equipment is no longer to be used in projects or programs currently or previously sponsored by the Federal Government, disposition of the equipment shall be made as follows:

(a) Equipment with a unit acquisition cost of less than $1,000 and equipment with no further use value. The equipment may be retained, sold, or otherwise disposed of, with no further obligation to the Federal Government.

(b) All other equipment. (1) The equipment may be retained or sold, and the Federal Government shall have a right to an amount calculated by multiplying the current market value or the proceeds from sale by the Federal share of the equipment (see §74.142). If part of the Federal share in the equipment came from an award under which the exemptions in §74.135 were applicable, the amount due shall be reduced pro rata. In any case, if the equipment is sold, $100 or 10 percent of the total sales proceeds, whichever is greater, may be deducted and retained from the amount otherwise due for selling and handling expenses.

(2) If the grantee's project or program for which or under which the equipment was acquired is still receiving grant support from the same Federal program and if the granting agency approves, the net amount due may be used for allowable costs of that project or program. Otherwise, the net amount must be remitted to the granting agency by check.

§74.140 Equipment management requirements.

Procedures for managing equipment (including replacement equipment) until transfer, replacement, or disposition takes place shall, as a minimum, meet the following requirements:

(a) Property records shall be maintained accurately. (Retention and access requirements for these records are explained in Subpart D of this part.) For each item of equipment, the records shall include:

(1) A description of the equipment, including manufacturer's model number, if any.

(2) An identification number, such as the manufacturer's serial number.

(3) Identification of the grant under which the recipient acquired the equipment.

(4) The information needed to calculate the Federal share of the equipment. (See §74.142.)

(5) Acquisition date and unit acquisition cost.

(6) Location, use, and condition of the equipment and the date the information was reported.

(7) All pertinent information on the ultimate transfer, replacement, or disposition of the equipment.

(b) A physical inventory of equipment shall be taken and the results reconciled with the property records at least once every 2 years to verify the existence, current utilization, and continued need for the equipment. A statistical sampling basis is acceptable. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the differences.

(c) A control system shall be in effect to insure adequate safeguards to prevent loss, damage, or theft of the equipment. Any loss, damage, or theft of equipment shall be investigated and fully documented.

(d) Adequate maintenance procedures shall be implemented to keep the equipment in good condition.

(e) Where equipment is to be sold and the Federal Government is to have a right to part or all of the proceeds, selling procedures shall be established which will provide for competition to the extent practicable and result in the highest possible return.

§74.141 Unused supplies.

(a) This section applies to supplies which have not yet been put to use in the project or program for which they were acquired when the grant or subgrant under which they were acquired expires or is terminated.

(b) If the unused supplies exceed $1,000 in total aggregate fair market value and are not needed for any project or program currently or previously funded by the Federal Government, the recipient may either retain or sell the supplies, and must credit the grant as follows:

(1) Retained supplies. The credit is computed by multiplying the Federal share of the supplies times their current market value.

(2) Sold supplies. The credit is computed by multiplying the Federal share of the supplies times the proceeds from sale. However, the recipient may reduce the credit by 10% of the sales proceeds, for selling and handling expenses.

(c) For possible exemptions from this section, see §74.135.

[46 FR 30501, June 9, 1981]

Federal Share of Real Property, Equipment, and Supplies

§74.142 Federal share of property.

Several sections of this subpart require a determination of the Federal (or non-Federal) share of real property, equipment, or supplies. In making such a determination, the following principles shall be observed:

(a) General. (1) Except as explained in the succeeding paragraphs of this section, the Federal share of the property shall be the same percentage as the Federal share of the acquiring party's total costs under the grant during the grant or subgrant year (or other funding period) to which the acquisition cost of the property was charged. For this purpose, ``costs under the grant'' means allowable costs which are either borne by the grant or counted towards satisfying a cost-sharing or matching requirement of the grant. Only costs are to be counted -- not the value of third-party in-kind contributions. Moreover, if the property was acquired by a grantee that awarded subgrants, costs incurred by its subgrantees shall be included only to the extent borne by the subgrants. (For example, if a subgrantee incurred $200,000 of project costs, of which $150,000 was borne by the subgrant, only the $150,000 shall be included in the grantee's costs.)

(2) If the property is acquired by a subgrantee, the Federal share of the subgrantee's costs under the grant and hence of the property shall be calculated by multiplying the Federal share of the grantee's costs by the latter's share of the subgrantee's costs. For example, if the Federal share of a grantee's costs is 50 percent and the subgrant bears only 50 percent of a subgrantee's costs, then the Federal share of that subgrantee's costs (and of the property acquired by that subgrantee) is 25 percent.

(b) Property acquired only partly under a grant. (1) Sometimes only a part of the acquisition cost of an item of property is borne as a direct cost by the grant or counted as a direct cost towards a cost-sharing or matching requirement. The remainder might, for example, represent voluntary cost sharing or matching, or it might be charged to a different activity. Occasionally, the amount paid for the property is only a part of its value, and the remainder is donated as an in-kind contribution by the party that provided the property.

(2) To calculate the Federal share of such property, first determine the Federal share of the acquiring party's total costs under the grant, as explained in the paragraph (a) of this section. Then multiply that share by the percentage of the property's acquisition cost (or its market value, if the item was partly donated) which was borne as a direct cost by the grant or counted as a direct cost towards a cost-sharing or matching requirement.

(c) Replacement equipment. The Federal share of replacement equipment shall be calculated as follows:

(1) Step 1. Determine the Federal share (percentage) of the equipment replaced.

(2) Step 2. Determine the percentage of the replacement equipment's cost that was covered by the amount received for trade-in or the sales proceeds from the equipment replaced.

(3) Step 3. Multiply the step 1 percentage by the step 2 percentage.

(4) Step 4. If an additional outlay for the replacement equipment was charged as a direct cost either to HHS grant funds or to required cost-sharing or matching funds, calculate the Federal share attributable to that additional outlay as explained in paragraph (b)(2) of this section. Add that additional percentage to the step 3 percentage.

(d) Institutional cost-sharing agreements. If a grant is subject to an institutional cost-sharing agreement (see §74.130(e)), the Federal share of property acquired under the grant shall be calculated as though there were no cost-sharing requirement applicable to the grant (that is, as if all the grantee's cost sharing were voluntary).

§74.143 Subgrantee's share of market value or sales proceeds.

Where this subpart requires a sharing of the market value or sales proceeds of property acquired under a subgrant, the non-Federal share shall be proportionally divided between the grantee and the subgrantee. The subgrantee shall be entitled to the amount it would have received or retained if the award to it had been made directly by the Federal Government. The remainder of the non-Federal share shall belong to the grantee.

Intangible Personal Property

§74.144 Inventions and patents.

HHS's regulations on inventions and patents arising out of activities assisted by a grant are set forth in Parts 6 and 8 of this title.

§74.145 Copyrights.

(a) Works under grants. Unless otherwise provided by the terms of the grant, when copyrightable material is developed in the course of or under a grant, the grantee is free to copyright the material or permit others to do so.

(b) Works under subgrants. Unless otherwise provided by the terms of the grant or subgrant, when copyrightable material is developed in the course of or under a subgrant, the subgrantee is free to copyright the material or permit others to do so.

(c) HHS rights. If any copyrightable material is developed in the course of or under a HHS grant or subgrant, HHS shall have a royalty-free, nonexclusive, and irrevocable right to reproduce, publish, or otherwise use, and to authorize others to use, the work for Federal Government purposes. A grantee awarding a subgrant may reserve a similar right for itself with respect to copyrightable material developed under that subgrant.

(d) Exemption of student-developed works. HHS awards training grants and other kinds of grants under which individuals are provided stipends or other financial assistance for the primary purpose of aiding them to further their education or training. Except as provided by the terms of the grant, copyrightable material developed by an individual or group of individuals in the course of education or training pursued with such assistance shall not be subject to the HHS right described in paragraph (c) of this section, unless the development of the material also receives other forms of support under the same or another HHS grant (such as a research grant).

Subpart P -- Procurements by Grantees and Subgrantees

Source: 45 FR 37667, June 3, 1980, unless otherwise noted.

§74.160 What procurements are subject to this subpart?

(a) This subpart applies to recipient procurements of supplies, equipment, and services (including construction).

(b) This subpart applies if any part of the cost of the property or service being procured by a recipient is treated as a direct cost under a grant or subgrant and is either borne by grant funds or counted toward satisfying a cost-sharing or matching requirement of the Federal grant. However, for research grants subject to an institutional cost-sharing agreement (see §74.50(b)), this subpart applies only if some part of the cost is borne by grant funds.

(c) This subpart does not apply to the acquisition of property or services by one government from another government or by one agency or instrumentality of a government from another agency or instrumentality of the same or another government.1 (FOOTNOTE)

(FOOTNOTE) 1Instrumentalities of a government include government institutions of higher education and government hospitals. However, those institutions and hospitals are not considered governmental organizations for the other purposes of this subpart. (See paragraph (c) of §74.4, ``Applicability of this part.'')

§74.161 What rules govern the procurements?

For procurements by governmental recipients, awarding parties and recipients shall comply with Attachment O, ``Procurement Standards,'' of OMB Circular A - 102. For procurements by nongovernmental recipients, awarding parties and recipients shall comply with Attachment O, ``Procurement Standards,'' of OMB Circular A - 110. The versions of the attachments that apply are those in effect on October 1, 1979. The texts of those versions are in Appendices G and H of this part.

§74.162 Must requests for OMB authorizations go through HHS's Office of Procurement, Assistance and Logistics (OPAL)?

Requests for the Office of Federal Procurement Policy approval or authorizations referred to in paragraphs 1.b, 1.c, and 14.j of the OMB Circular A - 102 attachment must be submitted, through appropriate HHS granting agency channels, to OPAL. If OPAL concurs in the request, OPAL sends it to the Office of Federal Procurement Policy of OMB.

[47 FR 53013, Nov. 24, 1982]

§74.163 How do the rules apply to subgrants?

(a) The Attachments O of the OMB circulars apply to procurements under subgrants as well as grants, although written, for the most part, in terms of grants. Except as explained in paragraphs (b) and (c) of this section, in the case of a subgrant, text that applies to a Federal agency is to be construed as applying to the grantee awarding the subgrant and text

that applies to a grantee is to be construed as applying to the recipient of the subgrant.

(b) In section 4 and paragraphs 14.d through 14.i of Attachment O of OMB Circular A - 102 and in paragraphs 4.e through 4.j of Attachment O of OMB Circular A - 110, the references to Federal agencies apply to Federal agencies even in the case of a subgrant.

(c) In paragraph 2.a of Attachment O of OMB Circular A - 102, the reference to a Federal concern is to be construed, in the case of a subgrant, as referring to a concern of either the Federal Government or the grantee awarding the subgrant.

§74.164 What clarifications are needed for the rule on access to contractor records?

The Attachments O require recipients to include in specified kinds of contracts a provision for access to the contractor's records by the recipient and the Federal Government. The following applies to the provision:

(a) The provision must require the contractor to place the same provision in any subcontract which would have to have the provision were it awarded directly by the recipient.

(b) The provision must require retention of records for three years after final payment is made under the contract or subcontract and all pending matters are closed. The provision must also require that, if an audit, litigation, or other action involving the records is started before the end of the three-year period, the records must be retained until all issues arising out of the action are resolved or until the end of the three-year period, whichever is later.

(c) In contracts and subcontracts under a subgrant, the provision must require that access to the records be provided to the grantee as well as the subgrantee and the Federal Government.

[45 FR 37667, June 3, 1980; 45 FR 38380, June 9, 1980]

Subpart Q -- Cost Principles

§74.170 Basic policy; scope of subpart.

Grant funds may be used only for allowable costs of the activities for which the grant was awarded. This subpart identifies the principles to be used in determining allowable costs. The principles apply to grant-support activities conducted by grantees as well as by subgrantees and cost-type contractors (and subcontractors) under grants.

[45 FR 34273, May 22, 1980]

§74.171 Governments.

(a) The principles to be used in determining the allowable costs of activities conducted by governments are contained in OMB Circular No. A-87, including any amendments to the Circular published in the Federal Register by OMB. A copy of this Circular may be obtained from the Division of Cost Allocation in any HHS Regional Office.

(b) Unless otherwise prescribed by OMB, future amendments to the Circular shall apply as of the start of a government's first fiscal year beginning after the amendment is published in the Federal Register.

[45 FR 34273, May 22, 1980, as amended at 47 FR 53013, Nov. 24, 1982]

§74.172 Institutions of higher education.

(a) The principles to be used in determining the allowable costs of activities conducted by institutions of higher education (other than for profit institutions) are contained in OMB Circular No. A - 21, including any amendments to the Circular published in the Federal Register by OMB. A copy of this Circular may be obtained from the Division of Cost Allocation in any HHS Regional Office.

(b) Unless otherwise prescribed by OMB, future amendments to the Circular shall apply as of the start of an institution's first fiscal year beginning after the amendment is published in the Federal Register.

[45 FR 34273, May 22, 1980]

§74.173 Hospitals.

(a) Research and development. The principles for determining the allowable costs of research and development work performed by hospitals are in Appendix E to this part.

(b) Other activities. Appendix E to this part shall be used as a guide for determining the allowable costs of other activities conducted by hospitals.

§74.174 Other nonprofit organizations.

(a) Except as provided in paragraph (c) of this section, the principles to be used in determining allowable costs of activities conducted by nonprofit organizations (other than governments, institutions of higher education, and hospitals) are contained in OMB Circular A - 122, including any amendments to the Circular published in the Federal Register by OMB. A copy of this Circular may be obtained from the Division of Cost Allocation in any HHS Regional Office. Unless otherwise prescribed by OMB, amendments to the Circular shall apply as of the start of an organization's first fiscal year beginning after the amendment is published in the Federal Register.

(b) OMB Circular A - 122 does not cover the treatment of bid and proposal costs or independent research and development costs. The following rules apply to these costs for nonprofit organizations subject to the Circular:

(1) Bid and proposal costs. Bid and proposal costs are the immediate costs of preparing bids, proposals, and applications for potential Federal and non - Federal grants, contracts, and agreements, including the development of scientific, cost, and other data needed to support the bids, proposals and applications. Bid and proposal costs of the current accounting period are allowable as indirect costs. Bid and proposal costs of past accounting periods are unallowable in the current period. However, if the organization's established practice is to treat these costs by some other method, they may be accepted if they are found to be reasonable and equitable. Bid and proposal costs do not include independent research and development costs covered by paragraph (b)(2) of this section, or preaward costs covered by Attachment B, Paragraph 33, of OMB Circular A - 122.

(2) Independent research and development costs. Independent research and development is research and development conducted by an organization which is not sponsored by Federal or non - Federal grants, contracts, or other agreements. Independent research and development shall be allocated its proportionate share of indirect costs on the same basis as the allocation of indirect costs to sponsored research and development. The costs of independent research and development, including its proportionate share of indirect costs, are unallowable.

(c) The principles to be used in determining allowable costs of activities conducted by the nonprofit organizations listed in Attachment C to OMB Circular A - 122 are contained in Subpart 1 - 15.2 of the Federal Procurement Regulations (41 CFR 1 - 15.2), except that the costs of independent research and development, including its proportionate share of indirect costs, are unallowable.

[46 FR 30502, June 9, 1981]

§74.175 For-profit organizations other than for-profit hospitals.

(a) The principles to be used in determining the allowable costs of activities conducted by for-profit organizations (other than for-profit hospitals) are contained in the Federal Procurement Regulations at 41 CFR Subpart 1 - 15.2. Exception: Independent research and development costs (including the indirect costs allocable to them) are unallowable. Independent research and development are defined in the Federal Procurement Regulations at 41 CFR 1 - 15.205 - 35.

(b) For hospitals, see §74.173.

[47 FR 53013, Nov. 24, 1982]

§74.176 Subgrants and cost-type contracts.

The cost principles applicable to a subgrantee or cost-type contractor under an HHS grant will not necessarily be the same as those applicable to the grantee. For example, where a State government awards a subgrant or cost-type contract to an institution of higher education, OMB Circular No. A - 21 will apply to the costs incurred by the institution of higher education even though OMB Circular No. A - 87 will apply to the costs incurred by the State.

[47 FR 53013, Nov. 24, 1982]

§74.177 Costs allowable with approval.

Each set of cost principles identifies certain costs that, in order to be allowable, must be approved by the granting agency. Other costs do not require approval. The following procedures govern approval of these costs.

(a) When costs are treated as indirect costs (or are allocated pursuant to a government-wide cost allocation plan), acceptance of the costs as part of the indirect cost rate or cost allocation plan shall constitute approval.

(b)(1) When the costs are treated as direct costs, they must be approved in advance by the awarding party.

(2) If the costs are specified in the budget, approval of the budget shall constitute approval of the costs.

(3) If the costs are not specified in the budget, or there is no approved budget, the recipient shall obtain specific prior approval in writing from the awarding party. For this purpose the prior approval procedures of §74.102 shall be followed, except that for formula or mandatory grants, the granting agency's written approval may be signed by any authorized official of the granting agency.

(c) The awarding party may waive or conditionally waive the requirement for its approval of the costs. Such a waiver shall apply only to the requirement for approval. If, upon audit or otherwise, it is determined that the costs do not meet other requirements or tests for allowability specified by the applicable cost principles, such as reasonableness and necessity, the costs may be disallowed.

(d) In the case of subgrants and cost-type contracts, no approval shall be given which is inconsistent with the purpose or the terms of the Federal grant.

[45 FR 22576, Apr. 3, 1980. Redesignated at 47 FR 53013, Nov. 24, 1982]

Subparts R -- S [Reserved]

Subpart T -- Miscellaneous

§74.304 Final decisions in disputes.

(a) Granting agencies and other Departmental components attempt to promptly issue final decisions in disputes and in other matters affecting the interests of grantees. However, they do not issue a final decision adverse to the grantee until it is clear that the matter cannot be resolved informally through further exchange of information and views.

(b) Under various HHS statutes or regulations, grantees have the right to appeal from, or to have a hearing on, certain final decisions by Departmental components. (See, for example, Subpart D of 42 CFR Part 50 and 45 CFR Parts 16 and 75.) Paragraphs (c) and (d) of this section set forth the standards the Department expects its components to meet in stating a final decision covered by any of the statutes or regulations.

(c) The decision is brief but contains --

(1) A complete statement of the background and basis of the component's decision, including reference to the pertinent statutes, regulations, or other governing documents; and

(2) Enough information to enable the grantee and any reviewer to understand the issues and the position of the HHS component.

(d) The following or similar language (consistent with the terminology of the applicable statutes or regulations) appears at the end of the decision: ``This is the final decision of the [title of grants officer or other official responsible for the decision]. It shall be the final decision of the Department unless, within 30 days after receiving this decision, you deliver or mail (you should use registered or certified mail to establish the date) a written notice of appeal to [name and address of appropriate contact; e.g., the Departmental Grant Appeals Board, Department of Health and Human Services, Washington, DC 20201]. You shall attach to the notice a copy of this decision, note that you intend an appeal, state the amount in dispute, and briefly state why you think that this decision is wrong. You will be notified of further procedures.''

(e) If a decision does not contain the statement, information, and language described in paragraphs (c) and (d) of this section, the decision is not necessarily the granting agency's final decision in the matter. The grantee should notify the granting agency that it wishes a formal final decision following any further exchange of views or information that might help resolve the matter informally.

[46 FR 43822, Aug. 31, 1981]

Subparts U -- Z [Reserved]

Subpart AA -- Special Provisions for Grants and Subgrants to For-Profit Organizations

Source: 47 FR 53014, Nov. 24, 1982, unless otherwise noted.

§74.701 Scope of subpart.

(a) This subpart contains provisions that apply to grants and subgrants to for-profit organizations. These provisions are in addition to other applicable portions of this part, or they make exceptions for awards to for-profit organizations from other provisions of this part.

(b) This subpart also draws attention to, or discusses, provisions elsewhere in this part that need special emphasis or clarification with respect to awards to for-profit organizations.

§74.705 Prohibition against profit.

Attention is directed to §74.170, which provides, in effect, that no grant funds may be paid as profit to any recipient of a grant or subgrant, even if the recipient is a for-profit organization. Profit is any amount in excess of allowable direct and indirect costs of the recipient.

§74.710 Real property, equipment, and supplies.

(a) Scope. (1) This section applies to real property, equipment, and supplies which, in accordance with §74.130, would be subject to Subpart O of this part but is acquired under a grant or subgrant to a for-profit organization.

(2) A grantee that is not a for-profit organization may take title to property acquired under a subgrant to a for-profit organization. If so, the property will be considered as acquired by the grantee under its grant, and this section will not apply to the property.

(b) Applicable rules. (1) Property subject to this section is exempt from Subpart O of this part. Instead, the clause entitled ``Government Property'' in 41 CFR 1 - 7.203 - 21(a) is deemed to be in every grant or subgrant to a for-profit organization, and the provisions in that clause that apply to property acquired for the Government apply to property subject to this section. For this purpose, the terms ``contract'' and its derivatives in that clause are considered to refer to the grant or subgrant under which the property is acquired, ``subcontract'' and its derivatives to refer to any subaward under that grant or subgrant, and ``contracting Officer'' to refer to the HHS grants officer.

(2) Records subject to the Government Property clause are exempt from Subpart D of this part.

(c) Approval for acquisition. A recipient shall not acquire property to be subject to this section without the prior approval of the granting agency.

§74.715 General program income.

The additional costs alternative described in §74.42(e) of this part may not be applied to general program income earned by a recipient that is a for-profit organization.

§74.720 Cost sharing under research grants.

Under research grants to for-profit organizations, HHS does not enter into institutional cost-sharing agreements that cover all or a number of its research project grants to the grantee in the aggregate. In research grants to these organizations, HHS implements statutory requirements for cost sharing through separate cost-sharing agreements negotiated for each research project.

Appendices A -- D to Part 74 [Reserved]

Pt. 74, App. E

Appendix E to Part 74 -- Principles for Determining Costs Applicable to Research and Development Under Grants and Contracts With Hospitals

i. purpose and scope

A. Objectives. This appendix provides principles for determining the costs applicable to research and development work performed by hospitals under grants and contracts with the Department of Health and Human Services. These principles are confined to the subject of cost determination and make no attempt to identify the circumstances or dictate the extent of hospital participation in the financing of a particular research or development project. The principles are designed to provide recognition of the full allocated costs of such research work under generally accepted accounting principles. These principles will be applicable to both proprietary and non-profit hospitals. No provision for profit or other increment above cost is provided for in these principles. However, this is not to be interpreted as precluding a negotiated fee between contracting parties when a fee is appropriate.

B. Policy guides. The successful application of these principles requires development of mutual understanding between representatives of hospitals and of the Department of Health and Human Services as to their scope, applicability and interpretation. It is recognized that:

1. The arrangements for hospital participation in the financing of a research and development project are properly subject to negotiation between

the agency and the hospital concerned in accordance with such Government-wide criteria as may be applicable.

2. Each hospital, possessing its own unique combination of staff, facilities and experience, should be encouraged to conduct research in a manner consonant with its own institutional philosophies and objectives.

3. Each hospital in the fulfillment of its contractual obligations should be expected to employ sound management practices.

4. The application of the principles established herein shall be in conformance with the generally accepted accounting practices of hospitals.

5. Hospitals receive reimbursements from the Federal Government for differing types of services under various programs such as support of Research and Development (including discrete clinical centers) Health Services Projects, Medicare, etc. It is essential that consistent procedures for determining reimbursable costs for similar services be employed without regard to program differences. Therefore, both the direct and indirect costs of research programs must be identified as a cost center(s) for the cost finding and step-down requirements of the Medicare program, or in its absence the Medicaid program.

C. Application. All operating agencies within the Department of Health and Human Services that sponsor research and development work in hospitals will apply these principles and related policy guides in determining the costs incurred for such work under grants and cost-reimbursement type contracts and subcontracts. These principles will also be used as a guide in the pricing of fixed-price contracts and subcontracts.

ii. definitions of terms

A. Organized research means all research activities of a hospital that may be identified whether the support for such research is from a federal, non-federal or internal source.

B. Departmental research means research activities that are not separately budgeted and accounted for. Such work, which includes all research activities not encompassed under the term organized research, is regarded for purposes of this document as a part of the patient care activities of the hospital.

C. Research agreement means any valid arrangement to perform federally-sponsored research or development including grants, cost-reimbursement type contracts, cost-reimbursement type subcontracts, and fixed-price contracts and subcontracts.

D. Instruction and training means the formal or informal programs of educating and training technical and professional health services personnel,

primarily medical and nursing training. This activity, if separately budgeted or identifiable with specific costs, should be considered as a cost objective for purposes of indirect cost allocations and the development of patient care costs.

E. Other hospital activities means all organized activities of a hospital not immediately related to the patient care, research, and instructional and training functions which produce identifiable revenue from the performance of these activities. If a non-related activity does not produce identifiable revenue, it may be necessary to allocate this expense using an appropriate basis. In such a case, the activity may be included as an allocable cost (See paragraph III D below.) Also included under this definition is any category of cost treated as ``Unallowable,'' provided such category of cost identifies a function or activity to which a portion of the institution's indirect cost (as defined in paragraph V. A.) are properly allocable.

F. Patient care means those departments or cost centers which render routine or ancillary services to in-patients and/or out-patients. As used in paragraph IX B.23, it means the cost of these services applicable to patients involved in research programs.

G. Allocation means the process by which the indirect costs are assigned as between:

1. Organized research,

2. Patient care including departmental research.

3. Instruction and training, and

4. Other hospital activities.

H. Cost center means an identifiable department or area (including research) within the hospital which has been assigned an account number in the hospital accounting system for the purpose of accumulating expense by department or area.

I. Cost finding is the process of recasting the data derived from the accounts ordinarily kept by a hospital to ascertain costs of the various types of services rendered. It is the determination of direct costs by specific identification and the proration of indirect costs by allocation.

J. Step down is a cost finding method that recognizes that services rendered by certain nonrevenue-producing departments or centers are utilized by certain other nonrevenue producing centers as well as by the revenue-producing centers. All costs of nonrevenue-producing centers are allocated to all centers which they serve, regardless of whether or not these centers produce revenue. Following the apportionment of the cost of the

nonrevenue-producing center, that center will be considered closed and no further costs are apportioned to that center.

K. Scatter bed is a bed assigned to a research patient based on availability. Research patients occupying these beds are not physically segregated from nonresearch patients occupying beds. Scatter beds are geographically dispersed among all the beds available for use in the hospital. There are no special features attendant to a scatter bed that distinguishes it from others that could just as well have been occupied.

L. Discrete bed is a bed or beds that have been set aside for occupancy by research patients and are physically segregated from other hospital beds in an environment that permits an easily ascertainable allocation of costs associated with the space they occupy and the services they generate.

iii. basic considerations

A. Composition of total costs. The cost of a research agreement is comprised of the allowable direct costs incident to its performance plus the allocable portion of the allowable indirect costs of the hospital less applicable credits. (See paragraph III - E.)

B. Factors affecting allowability of costs. The tests of allowability of costs under these principles are:

1. They must be reasonable.

2. They must be assigned to research agreements under the standards and methods provided herein.

3. They must be accorded consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances (See paragraph I - E.5.) and

4. They must conform to any limitations or exclusions set forth in these principles or in the research agreement as to types or amounts of cost items.

C. Reasonable costs. A cost may be considered reasonable if the nature of the goods or services acquired or applied, and the amount involved therefor reflect the action that a prudent person would have taken under the circumstances prevailing at the time the decision to incur the cost was made. Major considerations involved in the determination of the reasonableness of a cost are:

1. Whether or not the cost is of a type generally recognized as necessary for the operation of the hospital or the performance of the research agreement,

2. The restraints or requirements imposed by such factors as arm's length bargaining, federal and state laws and regulations, and research agreement terms and conditions,

3. Whether or not the individuals concerned acted with due prudence in the circumstances, considering their responsibilities to the hospital, its patients, its employees, its students, the Government, and the public at large, and

4. The extent to which the actions taken with respect to the incurrence of the cost are consistent with established hospital policies and practices applicable to the work of the hospital generally, including Government research.

D. Allocable costs. 1. A cost is allocable to a particular cost center (i.e., a specific function, project, research agreement, department, or the like) if the goods or services involved are chargeable or assignable to such cost center in accordance with relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a research agreement if it is incurred solely to advance the work under the research agreement; or it benefits both the research agreement and other work of the hospital in proportions that can be approximated through use of reasonable methods; or it is necessary to the overall operation of the hospital and, in light of the standards provided in this chapter, is deemed to be assignable in part to organized research. Where the purchase of equipment or other capital items are specifically authorized under a research agreement, the amounts thus authorized for such purchases are allocable to the research agreement regardless of the use that may subsequently be made of the equipment or other capital items involved.

2. Any costs allocable to a particular research agreement under the standards provided in these principles may not be shifted to other research agreements in order to meet deficiencies caused by overruns or other fund considerations, to avoid restrictions imposed by law or by terms of the research agreement, or for other reasons of convenience.

E. Applicable credits. 1. The term applicable credits refers to those receipts or negative expenditure types of transactions which operate to offset or reduce expense items that are allocable to research agreements as direct or indirect costs as outlined in paragraph V - A. Typical examples of such transactions are: purchase discounts, rebates, or allowances; recoveries or indemnities on losses; sales of scrap or incidental services; tuition; adjustments of overpayments or erroneous charges; and services rendered to patients admitted to federally funded clinical research centers, primarily for care though also participating in research protocols.

2. In some instances, the amounts received from the Federal Government to finance hospital activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the hospital

in determining the rates or amounts to be charged to government research for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by federal funds. Thus, where such items are provided for or benefit a particular hospital activity, i.e., patient care, research, instruction and training, or other, they should be treated as an offset to the indirect costs apportioned to that activity. Where the benefits are common to all hospital activities they should be treated as a credit to the total indirect cost pool before allocation to the various cost objectives.

iv. direct costs

A. General. Direct costs are those that can be identified specifically with a particular cost center. For this purpose, the term cost center refers not only to the ultimate centers against which costs are finally lodged such as research agreements, but also to other established cost centers such as the individual accounts for recording particular objects or items of expense, and the separate account groupings designed to record the expenses incurred by individual organizational units, functions, projects and the like. In general, the administrative functions and service activities described in paragraph VI are identifiable as separate cost centers, and the expenses associated with such centers become eligible in due course for distribution as indirect costs of research agreements and other ultimate cost centers.

B. Application to research agreements. Identifiable benefit to the research work rather than the nature of the goods and services involved is the determining factor in distinguishing direct from indirect costs of research agreements. Typical of transactions chargeable to a research agreement as direct costs are the compensation of employees for the time or effort devoted to the performance of work under the research agreement, including related staff benefit and pension plan costs to the extent that such items are consistently accorded to all employees and treated by the hospital as direct rather than indirect costs (see paragraph V. B4b); the costs of materials consumed or expended in the performance of such work; and other items of expense incurred for the research agreement, such as extraordinary utility consumption. The cost of materials supplied from stock or services rendered by specialized facilities or other institutional service operations may be included as direct costs of research agreements provided such items are consistently treated by the institution as direct rather than indirect costs and are charged under a recognized method of costing or pricing designed to recover only the actual direct and indirect costs of such material or service and conforming to generally accepted cost accounting practices consistently followed by the institution.

v. indirect costs

A. General. Indirect costs are those that have been incurred for common or joint objectives, and thus are not readily subject to treatment as direct costs of research agreements or other ultimate or revenue producing

cost centers. In hospitals such costs normally are classified but not necessarily restricted to the following functional categories: Depreciation; Administrative and General (including fringe benefits if not charged directly); Operation of Plant; Maintenance of Plant; Laundry and Linen Service; Housekeeping; Dietary; Maintenance of Personnel; and Medical Records and Library.

B. Criteria for distribution -- 1. Base period. A base period for distribution of indirect costs is the period during which such costs are incurred and accumulated for distribution to work performed within that period. The base period normally should coincide with the fiscal year established by the hospital, but in any event the base period should be so selected as to avoid inequities in the distribution of costs.

2. Need for cost groupings. The overall objective of the allocation process is to distribute the indirect costs described in paragraph VI to organized research, patient care, instruction and training, and other hospital activities in reasonable proportions consistent with the nature and extent of the use of the hospital's resources by research personnel, medical staff, patients, students, and other personnel or organizations. In order to achieve this objective with reasonable precision, it may be necessary to provide for selective distribution by establishing separate groupings of cost within one or more of the functional categories of indirect costs referred to in paragraph V - A. In general, the cost groupings established within a functional category should constitute, in each case, a pool of those items of expense that are considered to be of like character in terms of their relative contribution to (or degree of remoteness from) the particular cost centers to which distribution is appropriate. Each such pool or cost grouping should then be distributed individually to the related cost centers, using the distribution base or method most appropriate in the light of the guides set out in B3 below. While this paragraph places primary emphasis on a step-down method of indirect cost computation, paragraph VIII provides an alternate method which may be used under certain conditions.

3. Selection of distribution method. Actual conditions must be taken into account in selecting the method or base to be used in distributing to related cost centers the expenses assembled under each of the individual cost groups established as indicated under B2 above. Where a distribution can be made by assignment of a cost grouping directly to the area benefited, the distribution should be made in that manner. Care should be given, however, to eliminate similar or duplicative costs from any other distribution made to this area. Where the expenses under a cost grouping are more general in nature, the distribution to related cost centers should be made through use of a selected base which will produce results which are equitable to both the Government and the hospital. In general, any cost element or cost-related factor associated with the hospital's work is potentially adaptable for use as a distribution base provided:

a. It can readily be expressed in terms of dollars or other quantitative measure (total direct expenditures, direct salaries, manhours

applied, square feet utilized, hours of usage, number of documents processed, population served, and the like); and

b. It is common to the related cost centers during the base period. The essential consideration in selection of the distribution base in each instance is that it be the one best suited for assigning the pool of costs to related cost centers in accord with the relative benefits derived; the traceable cause and effect relationship; or logic and reason, where neither benefit nor cause and effect relationship is determinable.

4. General consideration on cost groupings. The extent to which separate cost groupings and selective distribution would be appropriate at a hospital is a matter of judgment to be determined on a case-by-case basis. Typical situations which may warrant the establishment of two or more separate cost groups (based on account classification or analysis) within a functional category include but are not limited to the following:

a. Where certain items or categories of expense relate solely to one of the major divisions of the hospital (patient care, sponsored research, instruction and training, or other hospital activities) or to any two but not all, such expenses should be set aside as a separate cost grouping for direct assignment or selective distribution in accordance with the guides provided in B2 and B3 above.

b. Where any types of expense ordinary treated as indirect cost as outlined in paragraph V - A are charged to research agreements as direct costs, the similar type expenses applicable to other activities of the institution must through separate cost grouping be excluded from the indirect costs allocable to research agreements.

c. Where it is determined that certain expenses are for the support of a service unit or facility whose output is susceptible of measurement on a workload or other quantitative basis, such expenses should be set aside as a separate cost grouping for distribution on such basis to organized research and other hospital activities.

d. Where organized activities (including identifiable segments of organized research as well as the activities cited in paragraph II - E) provide their own purchasing, personnel administration, building maintenance, or housekeeping or similar service, the distribution of such elements of indirect cost to such activities should be accomplished through cost grouping which includes only that portion of central indirect costs (such as for overall management) which are properly allocable to such activities.

e. Where the hospital elects to treat as indirect charges the costs of pension plans and other staff benefits, such costs should be set aside as a separate cost grouping for selective distribution to related cost centers, including organized research.

f. Where the hospital is affiliated with a medical school or some other institution which performs organized research on the hospital's premises, every effort should be made to establish separate cost groupings in the Administrative and General or other applicable category which will reasonably reflect the use of services and facilities by such research. (See also paragraph VII - A.3)

5. Materiality. Where it is determined that the use of separate cost groupings and selective distribution are necessary to produce equitable results, the number of such separate cost groupings within a functional category should be held within practical limits, after taking into consideration the materiality of the amounts involved and the degree of precision attainable through less selective methods of distribution.

C. Administration of limitations on allowances for indirect costs. 1. Research grants may be subject to laws and/or administrative regulations that limit the allowance for indirect costs under each such grant to a stated percentage of the direct costs allowed. Agencies that sponsor such grants will establish procedures which will assure that:

a. The terms and amount authorized in each case conform with the provisions of paragraphs III, V and IX of these principles as they apply to matters involving the consistent treatment and allowability of individual items of cost; and

b. The amount actually allowed for indirect costs under each such research grant does not exceed the maximum allowable under the limitation or the amount otherwise allowable under these principles, whichever is the smaller.

2. Where the actual allowance for indirect costs on any research grant must be restricted to the smaller of the two alternative amounts referred to in C1 above, such alternative amounts should be determined in accordance with the following guides:

a. The maximum allowable under the limitation should be established by applying the stated percentage to a direct cost base which shall include all items of expenditure authorized by the sponsoring agency for inclusion as part of the total cost for the direct benefit of the work under the grant; and

b. The amount otherwise allowable under these principles should be established by applying the current institutional indirect cost rate to those elements of direct cost which were included in the base on which the rate was computed.

3. When the maximum amount allowable under a statutory limitation or the terms of a research agreement is less than the amount otherwise allocable as indirect costs under these principles, the amount not recoverable as

indirect costs under the research agreement involved may not be shifted to other research agreements.

vi. identification and assignment of indirect costs

A. Depreciation or use charge. 1. The expenses under this heading should include depreciation (as defined in paragraph IX - B.9a) on buildings, fixed equipment, and movable equipment, except to the extent purchased through federal funds. Where adequate records for the recording of depreciation are not available, a use charge may be substituted for depreciation (See paragraph IX - B.)

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides set forth in paragraph V - B, on a basis that gives primary emphasis to (a) space utilization with respect to depreciation on buildings and fixed equipment; and (b) specific identification of assets and their use with respect to movable equipment as it relates to patient care, organized research, instruction and training, and other hospital activities. Where such records are not sufficient for the purpose of the foregoing, reasonable estimates will suffice as a means for effecting distribution of the amounts involved.

B. Administration and general expenses. 1. The expenses under this heading are those that have been incurred for the administrative offices of the hospital including accounting, personnel, purchasing, information centers, telephone expense, and the like which do not relate solely to any major division of the institution, i.e., solely to patient care, organized research, instruction and training, or other hospital activities.

2. The expenses included in this category may be allocated on the basis of total expenditures exclusive of capital expenditures, or salaries and wages in situations where the results of the distribution made on this basis are deemed to be equitable both to the Government and the hospital; otherwise the distribution of Administration and General expenses should be made through use of selected bases, applied to separate cost groupings established within this category of expenses in accordance with the guides set out in paragraph V - B.

C. Operation of plant. 1. The expenses under this heading are those that have been incurred by a central service organization or at the departmental level for the administration, supervision, and provision of utilities (exclusive of telephone expense) and protective services to the physical plant. They include expenses incurred for such items as power plant operations, general utility costs, elevator operations, protection services, and general parking lots.

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides provided in paragraph V - B, on a basis that gives primary emphasis to space utilization. The allocations should be developed as follows:

a. Where actual space and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various costs centers normally will suffice as a means for effecting distribution of the amounts involved; or

c. Where it can be demonstrated that an area or volume or space basis of allocation is impractical or inequitable, other bases may be used provided consideration is given to the use of facilities by research personnel and others, including patients.

D. Maintenance of plant. 1. The expenses under this heading should include:

a. All salaries and wages pertaining to ordinary repair and maintenance work performed by employees on the payroll of the hospital;

b. All supplies and parts used in the ordinary repairing and maintaining of buildings and general equipment; and

c. Amounts paid to outside concerns for the ordinary repairing and maintaining of buildings and general equipment.

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides provided in paragraph V - B. on a basis that gives primary emphasis to space utilization. The allocations and apportionments should be developed as follows:

a. Where actual space and related cost records are available and can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various cost centers normally will suffice as a means for effecting distribution of the amounts involved; or

c. Where it can be demonstrated that an area or volume of space basis of allocation is impractical or inequitable, other basis may be used provided consideration is given to the use of facilities by research personnel and others, including patients.

E. Laundry and linen. 1. The expenses under this heading should include:

a. Salaries and wages of laundry department employees, seamstresses, clean linen handlers, linen delivery men, etc.;

b. Supplies used in connection with the laundry operation and all linens purchased; and

c. Amounts paid to outside concerns for purchased laundry and/or linen service.

2. The expense included in this category should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V - B. on a basis that gives primary emphasis to actual pounds of linen used. The allocations should be developed as follows:

a. Where actual poundage and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where it can be demonstrated that a poundage basis of allocation is impractical or inequitable other bases may be used provided consideration is given to the use of linen by research personnel and others, including patients.

F. Housekeeping. 1. The expenses under this heading should include:

a. All salaries and wages of the department head, foreman, maids, porters, janitors, wall washers, and other housekeeping employees;

b. All supplies used in carrying out the housekeeping functions; and

c. Amounts paid to outside concerns for purchased services such as window washing, insect extermination, etc.

2. The expenses included in this category should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V - B. on a basis that gives primary emphasis to space actually serviced by the housekeeping department. The allocations and apportionments should be developed as follows:

a. Where actual space serviced and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space serviced and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various cost centers normally will suffice as a means for effecting distribution of the amounts of housekeeping expenses involved; or

c. Where it can be demonstrated that the space serviced basis of allocation is impractical or inequitable, other bases may be used provided consideration is given to the use of housekeeping services by research personnel and others, including patients.

G. Dietary. 1. These expenses, as used herein, shall mean only the subsidy provided by the hospital to its employees including research personnel through its cafeteria operation. The hospital must be able to demonstrate through the use of proper cost accounting techniques that the cafeteria operates at a loss to the benefit of employees.

2. The reasonable operating loss of a subsidized cafeteria operation should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V - B. on a basis that gives primary emphasis to number of employees.

H. Maintenance (housing) of personnel. 1. The expenses under this heading should include:

a. The salaries and wages of matrons, clerks, and other employees engaged in work in nurses' residences and other employees' quarters;

b. All supplies used in connection with the operation of such dormitories; and

c. Payments to outside agencies for the rental of houses, apartments, or rooms used by hospital personnel.

2. The expenses included in this category should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V - B. on a basis that gives primary emphasis to employee utilization of housing facilities. The allocation should be developed as follows:

a. Appropriate credit should be given for all payments received from employees or otherwise to reduce the expense to be allocated;

b. A net cost per housed employee may then be computed; and

c. Allocation should be made on a departmental basis based on the number of housed employees in each respective department.

I. Medical records and library. 1. The expenses under this heading should include:

a. The salaries and wages of the records librarian, medical librarian, clerks, stenographers, etc.; and

b. All supplies such as medical record forms, chart covers, filing supplies, stationery, medical library books, periodicals, etc.

2. The expenses included in this category should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V - B. on a basis that gives primary emphasis to a special time survey of medical records personnel. If this appears to be impractical or

inequitable, other bases may be used provided consideration is given to the use of these facilities by research personnel and others, including patients.

vii. determination and application of indirect cost rate or rates

A. Indirect cost pools. 1. Subject to (2) below, indirect costs allocated to organized research should be treated as a common pool, and the costs in such common pool should be distributed to individual research agreements benefiting therefrom on a single rate basis.

2. In some instances a single rate basis for use on all government research at a hospital may not be appropriate since it would not take into account those different environmental factors which may affect substantially the indirect costs applicable to a particular segment of government research at the institution. For this purpose, a particular segment of government research may be that performed under a single research agreement or it may consist of research under a group of research agreements performed in a common environment. The environmental factors are not limited to the physical location of the work. Other important factors are the level of the administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. Where a particular segment of government research is performed within an environment which appears to generate a significantly different level of indirect costs, provision should be made for a separate indirect cost pool applicable to such work. An example of this differential may be in the development of a separate indirect cost pool for a clinical research center grant. The separate indirect cost pool should be developed during the course of the regular distribution process, and the separate indirect cost rate resulting therefrom should be utilized provided it is determined that:

a. Such indirect cost rate differs significantly from that which would have obtained under (1) above; and

b. The volume of research work to which such rate would apply is material in relation to other government research at the institution.

3. It is a common practice for grants or contracts awarded to other institutions, typically University Schools of Medicine, to be performed on hospital premises. In these cases the hospital should develop a separate indirect cost pool applicable to the work under such grants or contracts. This pool should be developed by a selective distribution of only those indirect cost categories which benefit the work performed by the other institution, within the practical limits dictated by available data and the materiality of the amounts involved. Hospital costs determined to be allocable to grants or contracts awarded to another institution may not be recovered as a cost of grants or contracts awarded directly to the hospital.

B. The distribution base. Preferably, indirect costs allocated to organized research should be distributed to applicable research agreements on

the basis of direct salaries and wages. However, where the use of salaries and wages results in an inequitable allocation of costs to the research agreements, total direct costs or a variation thereof, may be used in lieu of salaries and wages. Regardless of the base used, an indirect cost rate should be determined for each of the separate indirect cost pools developed pursuant to paragraph VII - A. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the total direct salaries and wages (or other base selected) for all research agreements identified with such a pool.

C. Negotiated lump sum for overhead. A negotiated fixed amount in lieu of indirect costs may be appropriate for self-contained or off-campus research activities where the benefits derived from a hospital's indirect services cannot be readily determined. Such amount negotiated in lieu of indirect costs will be treated as an offset to the appropriate indirect cost pool after allocation to patient care, organized research, instruction and training, and other hospital activities. The base on which such remaining expenses are allocated should be appropriately adjusted.

D. Predetermined overhead rates. The utilization of predetermined fixed overhead rates may offer potential advantages in the administration of research agreements by facilitating the preparation of research budgets and permitting more expeditious close out of the agreements when the work is completed. Therefore, to the extent allowed by law, consideration may be given to the negotiation of predetermined fixed rates in those situations where the cost experience and other pertinent factors available are deemed sufficient to enable the Government and the hospital to reach a reasonable conclusion as to the probable level of the indirect cost rate for the ensuing accounting period.

viii. simplified method for small institutions

A. General. 1. Where the total direct cost of all government-sponsored research and development work at a hospital in a year is minimal, the use of the abbreviated procedure described in paragraph VIII - B below may be acceptable in the determination of allowable indirect costs. This method may also be used to initially determine a provisional indirect cost rate for hospitals that have not previously established a rate. Under this abbreviated procedure, data taken directly from the institution's most recent annual financial report and immediately available supporting information will be utilized as a basis for determining the indirect cost rate applicable to research agreements at the institution.

2. The rigid formula approach provided under the abbreviated procedure has limitations which may preclude its use at some hospitals either because the minimum data required for this purpose are not readily available or because the application of the abbreviated procedure to the available data produces results which appear inequitable to the Government or the hospital. In any such case, indirect costs should be determined through use of the regular procedure rather than the abbreviated procedure.

3. In certain instances where the total direct cost of all government-sponsored research and development work at the hospital is more than minimal, the abbreviated procedure may be used if prior permission is obtained. This alternative will be granted only in those cases where it can be demonstrated that the step-down technique cannot be followed.

B. Abbreviated procedure. 1. Total expenditures as taken from the most recent annual financial report will be adjusted by eliminating from further consideration expenditures for capital items as defined in paragraph IX - B.4 and unallowable costs as defined under various headings in paragraph IX and paragraph III - E.

2. Total expenditures as adjusted under the foregoing will then be distributed among (a) expenditures applicable to administrative and general overhead functions, (b) expenditures applicable to all other overhead functions, and (c) expenditures for all other purposes. The first group shall include amounts associated with the functional categories, Administration and General, and Dietary, as defined in paragraph VI. The second group shall include Depreciation, Operation of Plant, Maintenance of Plant, and Housekeeping. The third group -- expenditures for all other purposes -- shall include the amounts applicable to all other activities, namely, patient care, organized research, instruction and training, and other hospital activities as defined under paragraph II - E. For the purposes of this section, the functional categories of Laundry and Linen, Maintenance of Personnel, and Medical Records and Library as defined in paragraph VI shall be considered as expenditures for all other purposes.

3. The expenditures distributed to the first two groups in paragraph VIII - B.2 should then be adjusted by those receipts or negative expenditure types of transactions which tend to reduce expense items allocable to research agreements as indirect costs. Examples of such receipts or negative expenditures are itemized in paragraph III - E.1.

4. In applying the procedures in paragraphs VIII - B.1 and B.2, the cost of unallowable activities such as Gift Shop, Investment Property Management, Fund Raising, and Public Relations, when they benefit from the hospital's indirect cost services, should be treated as expenditures for all other purposes. Such activities are presumed to benefit from the hospital's indirect cost services when they include salaries of personnel working in the hospital. When they do not include such salaries, they should be eliminated from the indirect cost rate computation.

5. The indirect cost rate will then be computed in two stages. The first stage requires the computation of an Administrative and General rate component. This is done by applying a ratio of research direct costs over total direct costs to the Administrative and General pool developed under paragraphs VIII - B.2 and B.3 above. The resultant amount -- that which is allocable to research -- is divided by the direct research cost base. The second stage requires the computation of an All Other Indirect Cost rate component. This is done by applying a ratio of research direct space over

total direct space to All Other Indirect Cost pool developed under paragraphs VIII - B.2 and B.3 above. The resultant amount -- that which is allocable to research -- is divided by the direct research cost base.

The total of the two rate components will be the institution's indirect cost rate. For the purposes of this section, the research direct cost or space and total direct cost or space will be that cost or space identified with the functional categories classified under Expenditures for all other purposes under paragraph VIII - B.2.

ix. general standards for selected items of cost

A. General. This section provides standards to be applied in establishing the allowability of certain items involved in determining cost. These standards should apply irrespective of whether a particular item of cost is properly treated as direct cost or indirect cost. Failure to mention a particular item of cost in the standards is not intended to imply that it is either allowable or unallowable; rather, determination as to allowability in each case should be based on the treatment or standards provided for similar or related items of cost. In case of discrepancy between the provisions of a specific research agreement and the applicable standards provided, the provisions of the research agreement should govern. However, in some cases advance understandings should be reached on particular cost items in order that the full costs of research be supported. The extent of allowability of the selected items of cost covered in this section has been stated to apply broadly to many accounting systems in varying environmental situations. Thus, as to any given research agreement, the reasonableness and allocability of certain items of costs may be difficult to determine, particularly in connection with hospitals which have medical school or other affiliations. In order to avoid possible subsequent disallowance or dispute based on unreasonableness or nonallocability, it is important that prospective recipients of federal funds particularly those whose work is predominantly or substantially with the Government, seek agreement with the Government in advance of the incurrence of special or unusual costs in categories where reasonableness or allocability are difficult to determine. Such agreement may also be initiated by the Government. Any such agreement should be incorporated in the research agreement itself. However, the absence of such an advance agreement on any element of cost will not in itself serve to make that element either allowable or unallowable. Examples of costs on which advance agreements may be particularly important are:

1. Facilities costs, such as;

a. Depreciation

b. Rental

c. Use charges for fully depreciated assets

d. Idle facilities and idle capacity

e. Plant reconversion

f. Extraordinary or deferred maintenance and repair

g. Acquisition of automatic data processing equipment.

2. Preaward costs

3. Non-hospital professional activities

4. Self-insurance

5. Support services charged directly (computer services, printing and duplicating services, etc.)

6. Employee compensation, travel, and other personnel costs, including;

a. Compensation for personal service, including wages and salaries, bonuses and incentives, premium payments, pay for time not worked, and supplementary compensation and benefits, such as pension and retirement, group insurance, severance pay plans, and other forms of compensation

b. Morale, health, welfare, and food service and dormitory costs

c. Training and education costs

d. Relocation costs, including special or mass personnel movement

B. Selected items -- 1. Advertising costs. The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like. The only advertising costs allowable are those which are solely for;

a. The recruitment of persons required for the performance by the institution of obligations arising under the research agreement, when considered in conjunction with all other recruitment costs as set forth in paragraph IX - B.34.

b. The procurement of scarce items for the performance of the research agreement; or

c. The disposal of scrap or surplus materials acquired in the performance of the research agreement.

Costs of this nature, if incurred for more than one research agreement or for both research agreement work and other work of the institution, are allowable to the extent that the principles in paragraphs IV and V are observed.

2. Bad debts. Losses arising from uncollectible accounts and other claims and related collection and legal costs are unallowable except that a bad debt may be included as a direct cost of the research agreement to the extent that it is caused by a research patient and approved by the awarding agency. This inclusion is only intended to cover the situation of the patient admitted for research purposes who subsequently or in conjunction with the research receives clinical care for which a charge is made to the patient. If, after exhausting all means of collecting these charges, a bad debt results, it may be considered an appropriate charge to the research agreement.

3. Bonding costs. a. Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the hospital. They arise also in instances where the hospital requires similar assurance.

Included are such types as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the research agreement are allowable.

c. Costs of bonding required by the hospital in the general conduct of its business are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

4. Capital expenditures. The costs of equipment, buildings, and repairs which materially increase the value or useful life of buildings or equipment should be capitalized and are unallowable except as provided for in the research agreement.

5. Civil defense costs. Civil defense costs are those incurred in planning for, and the protection of life and property against the possible effects of enemy attack. Reasonable costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, fire-fighting training, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the institution's premises pursuant to suggestions or requirements of civil defense authorities are allowable when distributed to all activities of the institution. Capital expenditures for civil defense purposes will not be allowed, but a use allowance or depreciation may be permitted in accordance with provisions set forth elsewhere. Costs of local civil defense projects not on the institution's premises are unallowable.

6. Communication costs. Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage, and the like are allowable.

7. Compensation for personal services -- a. General. Compensation for personal services covers all remuneration paid currently or accrued to employees of the hospital for services rendered during the period of performance under government research agreements. Such remuneration includes salaries, wages, staff benefits (see paragraph IX - B.10), and pension plan costs (see paragraph IX - B.25). The costs of such remuneration are allowable to the extent that the total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the institution consistently applied, and provided that the charges for work performed directly on government research agreements and for other work allocable as indirect costs to sponsored research are determined and supported as hereinafter provided. For non-profit, non-proprietary institutions, where federally supported programs constitute less than a preponderance of the activity at the institution the primary test of reasonableness will be to require that the institution's compensation policies be applied consistently both to federally-sponsored and non-sponsored activities alike. However, where special circumstances so dictate a contractual clause may be utilized which calls for application of the test of comparability in determining the reasonableness of compensation.

b. Payroll distribution. Amounts charged to organized research for personal services, regardless of whether treated as direct costs or allocated as indirect costs, will be based on hospital payrolls which have been approved and documented in accordance with generally accepted hospital practices. In order to develop necessary direct and indirect allocations of cost, supplementary data on time or effort as provided in paragraph (c) below, normally need be required only for individuals whose compensation is properly chargeable to two or more research agreements or to two or more of the following broad functional categories: (1) Patient care; (2) organized research; (3) instruction and training; (4) indirect activities as defined in paragraph V - A; or (5) other hospital activities as defined in paragraph II - E.

c. Reporting time or effort. Charges for salaries and wages of individuals other than members of the professional staff will be supported by daily time and attendance and payroll distribution records. For members of the professional staff, current and reasonable estimates of the percentage distribution of their total effort may be used as support in the absence of actual time records. The term professional staff for purposes of this section includes physicians, research associates, and other personnel performing work at responsible levels of activities. These personnel normally fulfill duties, the competent performance of which usually requires persons possessing degrees from accredited institutions of higher learning and/or state licensure. In order to qualify as current and reasonable, estimates must be made no later than one month (though not necessarily a calendar month) after the month in which the services were performed.

d. Preparation of estimates of effort. Where required under paragraph (c) above, estimates of effort spent by a member of the professional staff on each research agreement should be prepared by the individual who performed

the services or by a responsible individual such as a department head or supervisor having first-hand knowledge of the services performed on each research agreement. Estimates must show the allocation of effort between organized research and all other hospital activities in terms of the percentage of total effort devoted to each of the broad functional categories referred to in (b) above. The estimate of effort spent on a research agreement may include a reasonable amount of time spent in activities contributing and intimately related to work under the agreement, such as preparing and delivering special lectures about specific aspects of the ongoing research, writing research reports and articles, participating in appropriate research seminars, consulting with colleagues with respect to related research, and attending appropriate scientific meetings and conferences. The term ``all other hospital activities'' would include departmental research, administration, committee work, and public services undertaken on behalf of the hospital.

e. Application of budget estimates. Estimates determined before the performance of services, such as budget estimates on a monthly, quarterly, or yearly basis do not qualify as estimates of effort spent.

f. Non-hospital professional activities. A hospital must not alter or waive hospital-wide policies and practices dealing with the permissible extent of professional services over and above those traditionally performed without extra hospital compensation, unless such arrangements are specifically authorized by the sponsoring agency. Where hospital-wide policies do not adequately define the permissible extent of consultantships or other non-hospital activities undertaken for extra pay, the Government may require that the effort of professional staff working under research agreements be allocated as between (1) hospital activities, and (2) non-hospital professional activities. If the sponsoring agency should consider the extent of non-hospital professional effort excessive, appropriate arrangements governing compensation will be negotiated on a case by case basis.

g. Salary rates for part-time appointments. Charges for work performed on government research by staff members having only part-time appointments will be determined at a rate not in excess of that for which he is regularly paid for his part-time staff assignment.

8. Contingency provisions. Contributions to a contingency reserve or any similar provisions made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable.

9. Depreciation and use allowances. a. Hospitals may be compensated for the use of buildings, capital improvements and usable equipment on hand through depreciation or use allowances. Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation.

Useful life has reference to the prospective period of economic usefulness in the particular hospital's operations as distinguished from physical life. Use allowances are the means of allowing compensation when depreciation or other equivalent costs are not considered.

b. Due consideration will be given to government-furnished research facilities utilized by the institution when computing use allowances and/or depreciation if the government-furnished research facilities are material in amount. Computation of the use allowance and/or depreciation will exclude both the cost or any portion of the cost of grounds, buildings and equipment borne by or donated by the Federal Government, irrespective of where title was originally vested or where it presently resides, and secondly, the cost of grounds. Capital expenditures for land improvements (paved areas, fences, streets, sidewalks, utility conduits, and similar improvements not already included in the cost of buildings) are allowable provided the systematic amortization of such capital expenditures has been provided in the institution's books of accounts, based on reasonable determinations of the probable useful lives of the individual items involved, and the share allocated to organized research is developed from the amount thus amortized for the base period involved.

c. Normal depreciation on a hospital's plant, equipment, and other capital facilities, except as excluded by (d) below, is an allowable element of research cost provided that the amount thereof is computed:

1. Upon the property cost basis used by the hospital for Federal Income Tax purposes (See section 167 of the Internal Revenue Code of 1954); or

2. In the case of non-profit or tax exempt organizations, upon a property cost basis which could have been used by the hospital for Federal Income Tax purposes, had such hospital been subject to the payment of income tax; and in either case

3. By the consistent application to the assets concerned of any generally accepted accounting method, and subject to the limitations of the Internal Revenue Code of 1954 as amended, including --

i. The straight line method;

ii. The declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in (i) above;

iii. The sum of the years-digits method; and

iv. Any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the use of the property and including the current year, does not during the first two-thirds of the useful life of the property exceed the total of such

allowances which would have been used had such allowances been computed under the method described in (ii) above.

d. Where the depreciation method is followed, adequate property records must be maintained. The period of useful service (service life) established in each case for usable capital assets must be determined on a realistic basis which takes into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular research area, and the renewal and replacement policies followed for the individual items or classes of assets involved. Where the depreciation method is introduced for application to assets acquired in prior years, the annual charges therefrom must not exceed the amounts that would have resulted had the depreciation method been in effect from the date of acquisition of such assets.

e. Depreciation on idle or excess facilities shall not be allowed except on such facilities as are reasonably necessary for standby purposes.

f. Where an institution elects to go on a depreciation basis for a particular class of assets, no depreciation, rental or use charge may be allowed on any such assets that would be viewed as fully depreciated; provided, however, that reasonable use charges may be negotiated for any such assets if warranted after taking into consideration the cost of the facility or item involved, the estimated useful life remaining at time of negotiation, the actual replacement policy followed in the light of service lives used for calculating depreciation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the facility or item for the purpose contemplated.

g. Hospitals which choose a depreciation allowance for assets purchased prior to 1966 based on a percentage of operating costs in lieu of normal depreciation for purposes of reimbursement under Pub. L. 89 - 97 (Medicare) shall utilize that method for determining depreciation applicable to organized research.

The operating costs to be used are the lower of the hospital's 1965 operating costs or the hospital's current year's allowable costs. The percent to be applied is 5 percent starting with the year 1966 - 67, with such percentage being uniformity reduced by one-half percent each succeeding year. The allowance based on operating costs is in addition to regular depreciation on assets acquired after 1965. However, the combined amount of such allowance on pre-1966 assets and the allowance for actual depreciation on assets acquired after 1965 may not exceed 6 percent of the hospital's allowable cost for the current year. After total depreciation has been computed, allocation methods are used to determine the share attributable to organized research.

For purposes of this section, Operating Costs means the total costs incurred by the hospital in operating the institution, and includes patient care, research, and other activities. Allowable Costs means operating costs less unallowable costs as defined in these principles; by the application of

allocation methods to the total amount of such allowable costs, the share attributable to Federally-sponsored research is determined.

A hospital which elects to use this procedure under Pub. L. 89 - 97 and subsequently changes to an actual depreciation basis on pre-1966 assets in accordance with the option afforded under the Medicare program shall simultaneously change to an actual depreciation basis for organized research.

Where the hospital desires to change to actual depreciation but either has no historical cost records or has incomplete records, the determination of historical cost could be made through appropriate means involving expert consultation with the determination being subject to review and approval by the Department of Health and Human Services.

h. Where the use allowance method is followed, the use allowance for buildings and improvements will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost of usable equipment in those cases where the institution maintains current records with respect to such equipment on hand. Where the institution's records reflect only the cost (actual or estimated) of the original complement of equipment, the use allowance will be computed at an annual rate not exceeding ten percent of such cost. Original complement for this purpose means the complement of equipment initially placed in buildings to perform the functions currently being performed in such buildings; however, where a permanent change in the function of a building takes place, a redetermination of the original complement of equipment may be made at that time to establish a new original complement. In those cases where no equipment records are maintained, the institution will justify a reasonable estimate of the acquisition cost of usable equipment which may be used to compute the use allowance at an annual rate not exceeding six and two-thirds percent of such estimate.

i. Depreciation and/or use charges should usually be allocated to research and other activities as an indirect cost.

10. Employee morale, health, and welfare costs and credits. The costs of house publications, health or first-aid benefits, recreational activities, employees' counseling services, and other expenses incurred in accordance with the hospital's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance, are allowable. Such costs will be equitably apportioned to all activities of the hospital. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

11. Entertainment costs. Except as pertains to 10 above, costs incurred for amusement, social activities, entertainment, and any items relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable.

12. Equipment and other facilities. The cost of equipment or other facilities are allowable on a direct charge basis where such purchases are approved by the sponsoring agency concerned or provided for by the terms of the research agreement.

13. Fines and penalties. Costs resulting from violations of, or failure of the institution to comply with federal, state and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the research agreement, or instructions in writing from the awarding agency.

14. Insurance and indemnification. a. Costs of insurance required or approved and maintained pursuant to the research agreement are allowable.

b. Costs of other insurance maintained by the hospital in connection with the general conduct of its activities are allowable subject to the following limitations: (1) Types and extent and cost of coverage must be in accordance with sound institutional practice; (2) costs of insurance or of any contributions to any reserve covering the risk of loss of or damage to government owned property are unallowable except to the extent that the Government has specifically required or approved such costs; and (3) costs of insurance on the lives of officers or trustees are unallowable except where such insurance is part of an employee plan which is not unduly restricted.

c. Contributions to a reserve for an approved self-insurance program are allowable to the extent that the types of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks. Such contributions are subject to prior approval of the Government.

d. Actual losses which could have been covered by permissible insurance (through an approved self-insurance program or otherwise) are unallowable unless expressly provided for in the research agreement, except that costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice as well as minor losses not covered by insurance such as spoilage, breakage and disappearance of small hand tools which occur in the ordinary course of operations are allowable.

15. Interest, fund raising and investment management costs. a. Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

b. Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are not allowable.

c. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are not allowable.

d. Costs related to the physical custody and control of monies and securities are allowable.

16. Labor relations costs. Costs incurred in maintaining satisfactory relations between the hospital and its employees, including costs of labor management committees, employees' publications, and other related activities are allowable.

17. Losses on research agreements or contracts. Any excess of costs over income under any agreement or contract of any nature is unallowable. This includes, but is not limited to, the hospital's contributed portion by reason of cost-sharing agreements, under-recoveries through negotiation of flat amounts for overhead, or legal or administrative limitations.

18. Maintenance and repair costs. a. Costs necessary for the upkeep of property (including government property unless otherwise provided for), which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are to be treated as follows:

1. Normal maintenance and repair costs are allowable;

2. Extraordinary maintenance and repair costs are allowable, provided they are allocated to the periods to which applicable for purposes of determining research costs.

b. Expenditures for plant and equipment, including rehabilitation thereof, which according to generally accepted accounting principles as applied under the hospital's established policy, should be capitalized and subjected to depreciation, are allowable only on a depreciation basis.

19. Material costs. Costs incurred for purchased materials, supplies and fabricated parts directly or indirectly related to the research agreement, are allowable. Purchases made specifically for the research agreement should be charged thereto at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the institution. Withdrawals from general stores or stockrooms should be charged at their cost under any recognized method of pricing stores withdrawals conforming to sound accounting practices consistently followed by the hospital. Incoming transportation charges are a proper part of material cost. Direct material cost should include only the materials and supplies actually used for the performance of the research agreement, and due credit should be given for any excess materials retained or returned to vendors. Due credit should be given for all proceeds or value received for any scrap resulting from work under the research agreement. Where government donated or furnished material is used in performing the research agreement, such material will be used without charge.

20. Memberships, subscriptions and professional activity costs. a. Costs of the hospital's membership in civic, business, technical and professional organizations are allowable.

b. Costs of the hospital's subscriptions to civic, business, professional and technical periodicals are allowable.

c. Costs of meetings and conferences, when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, and other items incidental to such meetings or conferences.

21. Organization costs. Expenditures such as incorporation fees, attorneys' fees, accountants' fees, brokers' fees, fees to promoters and organizers in connection with (a) organization or reorganization of a hospital, or (b) raising capital, are unallowable.

22. Other business expenses. Included in this item are such recurring expenses as registry and transfer charges resulting from changes in ownership of securities issued by the hospital, cost of shareholders meetings preparation and publication of reports to shareholders, preparation and submission of required reports and forms to taxing and other regulatory bodies, and incidental costs of directors and committee meetings. The above and similar costs are allowable when allocated on an equitable basis.

23. Patient care. The cost of routine and ancillary or special services to research patients is an allowable direct cost of research agreements.

a. Routine services shall include the costs of the regular room, dietary and nursing services, minor medical and surgical supplies and the use of equipment and facilities for which a separate charge is not customarily made.

b. Ancillary or special services are the services for which charges are customarily made in addition to routine services, such as operating rooms, anesthesia, laboratory, BMR-EKG, etc.

c. Patient care, whether expressed as a rate or an amount, shall be computed in a manner consistent with the procedures used to determine reimbursable costs under Pub. L. 89 - 97 (Medicare Program) as defined under the ``Principles Of Reimbursement For Provider Costs'' published by the Social Security Administration of the Department of Health and Human Services. The allowability of specific categories of cost shall be in accordance with those principles rather than the principles for research contained herein. In the absence of participation in the Medicare program by a hospital, all references to the Medicare program in these principles shall be construed as meaning the Medicaid program.

i. Once costs have been recognized as allowable, the indirect costs or general service center's cost shall be allocated (stepped-down) to special service centers, and all patient and nonpatient costs centers based upon actual services received or benefiting these centers.

ii. After allocation, routine and ancillary costs shall be apportioned to scatter-bed research patients on the same basis as is used to apportion costs to Medicare patients, i.e. using either the departmental method or the combination method, as those methods are defined by the Social Security Administration; except that final settlement shall be on a grant-by-grant basis. However, to the extent that the Social Security Administration has recognized any other method of cost apportionment, that method generally shall also be recognized as applicable to the determination of research patient care costs.

iii. A cost center must be established on Medicare reimbursement forms for each discrete-bed unit grant award received by a hospital. Routine costs should be stepped-down to this line item(s) in the normal course of stepping-down costs under Medicare/Medicaid requirements. However, in stepping-down routine costs, consideration must be given to preventing a step-down of those costs to discrete-bed unit line items that have already been paid for directly by the grant, such as bedside nursing costs. Ancillary costs allocable to research discrete-bed units shall be determined and proposed in accordance with Section 23.c.ii.

d. Where federally sponsored research programs provide specifically for the direct reimbursement of nursing, dietary, and other services, appropriate adjustment must be made to patient care costs to preclude duplication and/or misallocation of costs.

24. Patent costs. Costs of preparing disclosures, reports and other documents required by the research agreement and of searching the art to the extent necessary to make such invention disclosures are allowable. In accordance with the clauses of the research agreement relating to patents, costs of preparing documents and any other patent costs, in connection with the filing of a patent application where title is conveyed to the Government, are allowable. (See also paragraph IX - B.36.)

25. Pension plan costs. Costs of the hospital's pension plan which are incurred in accordance with the established policies of the institution are allowable, provided such policies meet the test of reasonableness and the methods of cost allocation are not discriminatory, and provided appropriate adjustments are made for credits or gains arising out of normal and abnormal employee turnover or any other contingencies that can result in forfeitures by employees which inure to the benefit of the hospital.

26. Plan security costs. Necessary expenses incurred to comply with government security requirements including wages, uniforms and equipment of personnel engaged in plant protection are allowable.

27. Preresearch agreement costs. Costs incurred prior to the effective date of the research agreement, whether or not they would have been allowable thereunder if incurred after such date, are unallowable unless specifically set forth and identified in the research agreement.

28. Professional services costs. a. Costs of professional services rendered by the members of a particular profession who are not employees of the hospital are allowable subject to (b) and (c) below when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government. Retainer fees to be allowable must be reasonably supported by evidence of services rendered.

b. Factors to be considered in determining the allowability of costs in a particular case include (1) the past pattern of such costs, particularly in the years prior to the award of government research agreements on the institution's total activity; (2) the nature and scope of managerial services expected of the institution's own organizations; and (3) whether the proportion of government work to the hospital's total activity is such as to influence the institution in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under government research agreements.

c. Costs of legal, accounting and consulting services, and related costs incurred in connection with organization and reorganization or the prosecution of claims against the Government are unallowable. Costs of legal, accounting and consulting services, and related costs incurred in connection with patent infringement litigation are unallowable unless otherwise provided for in the research agreement.

29. Profits and losses on disposition of plant equipment, or other assets. Profits or losses of any nature arising from the sale or exchange of plant, equipment, or other capital assets, including sales or exchange of either short- or long-term investments, shall be excluded in computing research agreement costs.

30. Proposal costs. Proposal costs are the costs of preparing bids or proposals on potential government and non-government research agreements or projects, including the development of technical data and cost data necessary to support the institution's bids or proposals. Proposal costs of the current accounting period of both successful and unsuccessful bids and proposals normally should be treated as indirect costs and allocated currently to all activities of the institution, and no proposal costs of past accounting periods will be allocable in the current period to the government research agreement. However, the institution's established practices may be to treat proposal costs by some other recognized method. Regardless of the methods used, the results obtained may be accepted only if found to be reasonable and equitable.

31. Public information services costs. Costs of news releases pertaining to specific research or scientific accomplishment are unallowable unless specifically authorized by the sponsoring agency.

32. Rearrangement and alteration costs. Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special rearrangement and alteration costs incurred specifically for a project are allowable only as a direct charge when such work has been approved in advance by the sponsoring agency concerned.

33. Reconversion costs. Costs incurred in the restoration or rehabilitation of the institution's facilities to approximately the same condition existing immediately prior to commencement of government research agreement work, fair wear and tear excepted, are allowable.

34. Recruiting costs. a. Subject to (b), (c), and (d) below, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, costs of ``help wanted'' advertising, operating costs of an employment office necessary to secure and maintain an adequate staff, costs of operating an aptitude and educational testing program, travel costs of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees are allowable to the extent that such costs are incurred pursuant to a well managed recruitment program. Where an institution uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

b. In publications, costs of help wanted advertising that includes color, includes advertising material for other than recruitment purposes, or is excessive in size (taking into consideration recruitment purposes for which intended and normal institutional practices in this respect) are unallowable.

c. Costs of help wanted advertising, special emoluments; fringe benefits, and salary allowances incurred to attract professional personnel from other institutions that do not meet the test of reasonableness or do not conform with the established practices of the institution are unallowable.

d. Where relocation costs incurred incident to recruitment of a new employee have been allowed either as an allocable direct or indirect cost, and the newly hired employee resigns for reasons within his control within twelve months after hire, the institution will be required to refund or credit such relocations costs as were charged to the Government.

35. Rental costs (including sale and lease-back of facilities). a. Rental costs of land, building, and equipment and other personal property are allowable if the rates are reasonable in light of such factors as rental costs of comparable facilities and market conditions in the area, the type, life expectancy, condition, and value of the facilities leased, options available, and other provisions of the rental agreement. Application of these

factors, in situations where rentals are extensively used, may involve among other considerations comparison of rental costs with the amount which the hospital would have received had it owned the facilities.

b. Charges in the nature of rent between organizations having a legal or other affiliation or arrangement such as hospitals, medical schools, foundations, etc., are allowable to the extent such charges do not exceed the normal costs of ownership such as depreciation, taxes, insurance, and maintenance, provided that no part of such costs shall duplicate any other allowed costs.

c. Unless otherwise specifically provided in the agreement, rental costs specified in sale and lease-back agreements incurred by hospitals through selling plant facilities to investment organizations such as insurance companies or to private investors, and concurrently leasing back the same facilities are allowable only to the extent that such rentals do not exceed the amount which the hospital would have received had it retained legal title to the facilities.

36. Royalties and other costs for use of patents. Royalties on a patent or amortization of the cost of acquiring a patent or invention or rights thereto necessary for the proper performance of the research agreement and applicable to tasks or processes thereunder are allowable unless the Government has a license or the right to free use of the patent, the patent has been adjudicated to be invalid, or has been administratively determined to be invalid, the patent is considered to be unenforceable, or the patent has expired.

37. Severance pay. a. Severance pay is compensation in addition to regular salaries and wages which is paid by a hospital to employees whose services are being terminated. Costs of severance pay are allowable only to the extent that such payments are required by law, by employer-employee agreement, by established policy that constitutes in effect an implied agreement on the institution's part, or by circumstances of the particular employment.

b. Severance payments that are due to normal, recurring turnover, and which otherwise meet the conditions of (a) above may be allowed provided the actual costs of such severance payments are regarded as expenses applicable to the current fiscal year and are equitably distributed among the institution's activities during that period.

c. Severance payments that are due to abnormal or mass terminations are of such conjectural nature that allowability must be determined on a case-by-case basis. However, the Government recognizes its obligation to participate to the extent of its fair share in any specific payment.

38. Specialized service facilities operated by a hospital. a. The costs of institutional services involving the use of highly complex and specialized facilities such as electronic computers and reactors are

allowable provided the charges therefor meet the conditions of (b) or (c) below, and otherwise take into account any items of income or federal financing that qualify as applicable credits under paragraph III - E.

b. The costs of such hospital services normally will be charged directly to applicable research agreements based on actual usage or occupancy of the facilities at rates that (1) are designed to recover only actual costs of providing such services, and (2) are applied on a nondiscriminatory basis as between organized research and other work of the hospital including commercial or accommodation sales and usage by the hospital for internal purposes. This would include use of such facilities as radiology, laboratories, maintenance men used for a special purpose, medical art, photography, etc.

c. In the absence of an acceptable arrangement for direct costing as provided in (b) above, the costs incurred for such institutional services may be assigned to research agreements as indirect costs, provided the methods used achieve substantially the same results. Such arrangements should be worked out in coordination with all government users of the facilities in order to assure equitable distribution of the indirect costs.

39. Special administrative costs. Costs incurred for general public relations activities, catalogs, alumni activities, and similar services are unallowable.

40. Staff and/or employee benefits. a. Staff and/or employee benefits in the form of regular compensation paid to employees during periods of authorized absences from the job such as for annual leave, sick leave, military leave and the like are allowable provided such costs are absorbed by all hospital activities including organized research in proportion to the relative amount of time or effort actually devoted to each.

b. Staff benefits in the form of employer contributions or expenses for Social Security taxes, employee insurance, Workmen's Compensation insurance, the Pension Plan (see paragraph IX - B.25), hospital costs or remission of hospital charges to the extent of costs for individual employees or their families, and the like are allowable provided such benefits are granted in accordance with established hospital policies, and provided such contributions and other expenses whether treated as indirect costs or an increment of direct labor costs are distributed to particular research agreements and other activities in a manner consistent with the pattern of benefits accruing to the individuals or groups of employees whose salaries and wages are chargeable to such research agreements and other activities.

41. Taxes. a. In general, taxes which the hospital is required to pay and which are paid or accrued in accordance with generally accepted accounting principles, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable except for (1) taxes from which exemptions are available to the hospital directly or which are available to the hospital based on an

exemption afforded the Government and in the latter case when the sponsoring agency makes available the necessary exemption certificates, (2) special assessments on land which represent capital improvements, and (3) Federal Income Taxes.

b. Any refund of taxes, interest, or penalties, and any payment to the hospital of interest thereon attributable to taxes, interest or penalties, which were allowed as research agreement costs will be credited or paid to the Government in the manner directed by the Government provided any interest actually paid or credited to a hospital incident to a refund of tax, interest, and penalty will be paid or credited to the Government only to the extent that such interest accrued over the period during which the hospital had been reimbursed by the Government for the taxes, interest, and penalties.

42. Transportation costs. Costs incurred for inbound freight, express, cartage, postage and other transportation services relating either to goods purchased, in process, or delivered are allowable. When such costs can readily be identified with the items involved, they may be charged directly as transportation costs or added to the cost of such items. Where identification with the material received cannot readily be made, inbound transportation costs may be charged to the appropriate indirect cost accounts if the institution follows a consistent equitable procedure in this respect. Outbound freight, if reimbursable under the terms of the research agreement, should be treated as a direct cost.

43. Travel costs. a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the hospital. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed by the institution in its regular operations.

b. Travel costs are allowable subject to (c) and (d) below when they are directly attributable to specific work under a research agreement or when they are incurred in the normal course of administration of the hospital or a department or research program thereof.

c. The difference in cost between first class air accommodations and less than first class air accommodations is unallowable except when less than first class air accommodations are not reasonably available to meet necessary mission requirements such as where less than first class accommodations would (1) require circuitous routing, (2) require travel during unreasonable hours, (3) greatly increase the duration of the flight, (4) result in additional costs which would offset the transportation savings, or (5) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Costs of personnel movements of a special or mass nature are allowable only when authorized or approved in writing by the sponsoring agency or its authorized representative.

44. Termination costs applicable to contracts. a. Contract terminations generally give rise to the incurrence of costs or to the need for special treatment of costs which would not have arisen had the contract not been terminated. Items peculiar to termination are set forth below. They are to be used in conjunction with all other provisions of these principles in the case of contract termination.

b. The cost of common items of material reasonably usable on the hospital's other work will not be allowable unless the hospital submits evidence that it could not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the institution, consideration should be given to the hospital's plans for current scheduled work or activities including other research agreements. Contemporaneous purchases of common items by the hospital will be regarded as evidence that such items are reasonably usable on the hospital's other work. Any acceptance of common items as allowable to the terminated portion of the contract should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirement of other work.

c. If in a particular case, despite all reasonable efforts by the hospital, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in these principles, except that any such costs continuing after termination due to the negligent or willful failure of the hospital to discontinue such costs will be considered unacceptable.

d. Loss of useful value of special tooling and special machinery and equipment is generally allowable, provided (1) such special tooling, machinery or equipment is not reasonably capable of use in the other work of the hospital; (2) the interest of the Government is protected by transfer of title or by other means deemed appropriate by the contracting officer; and (3) the loss of useful value as to any one terminated contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the contract bears to the entire terminated contract and other government contracts for which the special tooling, special machinery or equipment was acquired.

e. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated contract, less the residual value of such leases, if (1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable; and (2) the hospital makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property,

provided such alterations were necessary for the performance of the contract and of reasonable restoration required by the provisions of the lease.

f. Settlement expenses including the following are generally allowable: (1) Accounting, legal, clerical, and similar costs reasonably necessary for the preparation and presentation to contracting officers of settlement claims and supporting data with respect to the terminated portion of the contract and the termination and settlement of subcontracts; and (2) reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced by the institution for the contract.

g. Subcontractor claims including the allocable portion of claims which are common to the contract and to other work of the contractor are generally allowable.

45. Voluntary services. The value of voluntary services provided by sisters or other members of religious orders is allowable provided that amounts do not exceed that paid other employees for similar work. Such amounts must be identifiable in the records of the hospital as a legal obligation of the hospital. This may be reflected by an agreement between the religious order and the hospital supported by evidence of payments to the order.

[45 FR 22610, Apr. 3, 1980]

Appendix F to Part 74 -- [Reserved]

Appendix G to Part 74 -- Attachment O, ``Procurement Standards,'' of OMB Circular A - 102, ``Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments''

1. Applicability.

a. This Attachment establishes standards and guidelines for the procurement of supplies, equipment, construction, and services for Federal assistance programs. These standards are furnished to ensure that such materials and services are obtained efficiently and economically and in compliance with the provisions of applicable Federal law and Executive orders.

b. No additional procurement requirements or subordinate regulations shall be imposed upon grantees by Executive agencies unless specifically required by Federal law or Executive orders or authorized by the Administrator for Federal Procurement Policy. This prohibition is not applicable to payment conditions issued in accordance with Treasury Circular

1075, individual grantee requirements pursuant to section 10 of the basic circular1 (FOOTNOTE) or the provisions of this or other OMB circulars.

(FOOTNOTE) 1For HHS grants and subgrants, the requirements referred to are those issued under 45 CFR 74.7, ``Special grant or subgrant conditions.''

c. Provisions of current subordinate requirements not conforming to this attachment shall be rescinded by grantor agencies unless approved by the Office of Federal Procurement Policy (OFPP).

2. Grantee/Grantor Responsibility.

a. These standards do not relieve the grantee of any contractual responsibilities under its contracts. The grantee is responsible, in accordance with good administrative practice and sound business judgment, for the settlement of all contractual and administrative issues arising out of procurements entered into in support of a grant. These include but are not limited to: source evaluation, protests, disputes, and claims. Executive agencies shall not substitute their judgment for that of the grantee unless the matter is primarily a Federal concern. Violations of law are to be referred to the local, State, or Federal authority having proper jurisdiction.

b. Grantees shall use their own procurement procedures which reflect applicable State and local laws and regulations, provided that procurements for Federal Assistance Programs conform to the standards set forth in this attachment and applicable Federal law.

3. Grantee Procurement Improvement.

Executive agencies awarding Federal grants or other assistance which require or allow for procurement by the recipients are encouraged to assist recipients in improving their procurement capabilities by providing them with technical assistance, training, publications, and other aid.

4. Procurement System Reviews.

a. Executive agencies are encouraged to perform reviews of their grantees' procurement systems if a continuing relationship with the grantee is anticipated or a substantial amount of the Federal assistance is to be used for procurement and review of individual contracts is anticipated. The purpose of the review shall be to determine: (1) Whether a grantee's procurement system meets the standards prescribed by this Attachment or other criteria acceptable to the OFPP, such as provisions of the model procurement code for State and local government and (2) whether the grantee's procurement system should be certified by the reviewing agency. Such a review will also give an agency an opportunity to give technical assistance to a grantee to remedy its procurement system if it does not fully comply. In addition, such a review may provide a basis for deciding whether the grantee's contracts and

related procurement documents should be subject to the grantor's prior approval, as provided by Section 6.

b. In conducting procurement system reviews, grantor agencies will evaluate a grantee's procurement system in terms of whether it complies with the standards prescribed by this Attachment and represents a fair, efficient and effective procurement system. To the maximum extent feasible, reviewers will rely upon State or local evaluations and analyses performed by agencies or organizations independent of the grantee contracting activity.

c. When a Federal grantor agency completes a procurement review, it shall furnish a report to the grantee, with a copy to OFPP.

d. All agencies should normally rely upon the resultant findings or certification for a period of 24 months before another review is performed.

e. Reviews shall be conducted in accordance with standards and guidelines approved or issued by OFPP.

f. The reviews authorized by Section 6 are waived if a grantee's procurement system is certified.

5. Protest Procedures.

Grantor agencies may develop an administrative procedure to handle complaints or protests regarding grantee contractor selection actions. The procedure shall be limited as follows:

a. No protest shall be accepted by the grantor agency until all administrative remedies at the grantee level have been exhausted.

b. Review is limited to:

(i) Violations of Federal law or regulations. Violations of State or local law shall be under the jurisdiction of State or local authorities.

(ii) Violations of grantee's protest procedures or failure to review a complaint or protest.

6. Grantor Review of Proposed Contracts.

Federal grantor pre-award review and approval of the grantee's proposed contracts and related procurement documents, such as requests for proposals and invitations for bids, is permitted only under the following circumstances:

a. The procurement is expected to exceed $10,000 and is to be awarded without competition or only one bid or offer is received in response to solicitation.

b. The procurement expected to exceed $10,000 specifies a ``brand name'' product; or

c. The grantee's procurement procedures or operation fails to comply with one or more significant aspects of this Attachment. The grantor agency shall notify the grantee in writing, with a copy of such notification to the OFPP.

7. Code of Conduct.

Grantees shall maintain a written code or standards of conduct which shall govern the performance of their officers, employees or agents engaged in the award and administration of contracts supported by Federal funds. No employee, officer or agent of the grantee shall participate in selection, or in the award or administration of a contract supported by Federal funds if a conflict of interest, real or apparent, would be involved. Such a conflict would arise when:

a. The employee, officer or agent;

b. Any member of his immediate family;

c. His or her partner; or

d. An organization which employs, or is about to employ, any of the above, has a financial or other interest in the firm selected for award.

The grantee's officers, employees or agents shall neither solicit nor accept gratuities, favors or anything of monetary value from contractors, potential contractors, or parties to subagreements.

Grantees may set minimum rules where the financial interest is not substantial or the gift is an unsolicited item of nominal intrinsic value.

To the extent permitted by State or local law or regulations, such standards of conduct shall provide for penalties, sanctions, or other disciplinary actions for violations of such standards by the grantee's officers, employees, or agents, or by contractors or their agents.

8. Procurement Procedures.

The grantee shall establish procurement procedures which provide that proposed procurement actions shall be reviewed by grantee officials to avoid the purchase of unnecessary or duplicative items. Consideration should be given to consolidation or breaking out to obtain a more economical purchase. Where appropriate, an analysis shall be made of lease versus purchase alternatives, and any other appropriate analysis to determine which approach would be the most economical. To foster greater economy and efficiency grantees are encouraged to enter into State and local intergovernmental agreements for procurement or use of common goods and services.

9. Contracting With Small and Minority Firms, Women's Business Enterprise and Labor Surplus Area Firms.

a. It is national policy to award a fair share of contracts to small and minority business firms. Accordingly, affirmative steps must be taken to assure that small and minority businesses are utilized when possible as sources of supplies, equipment, construction and services. Affirmative steps shall include the following:

(1) Including qualified small and minority businesses on solicitation lists.

(2) Assuring that small and minority businesses are solicited whenever they are potential sources.

(3) When economically feasible, dividing total requirements into smaller tasks or quantities so as to permit maximum small and minority business participation.

(4) Where the requirement permits, establishing delivery schedules which will encourage participation by small and minority business.

(5) Using the services and assistance of the Small Business Administration, the Office of Minority Business Enterprise of the Department of Commerce and the Community Services Administration as required.2 (FOOTNOTE)

(FOOTNOTE) 2 Additional advice and assistance regarding the use of small or minority businesses may be obtained from the following HHS components:

1. The Office of Facilities Engineering and its regional offices (for assistance in identifying minority-owned firms interested in performing construction, alteration, or renovation work).

2. The Office of Grants and Procurement.

(6) If any subcontracts are to be let, requiring the prime contractor to take the affirmative steps in 1 through 5 above.

b. Grantees shall take similar appropriate affirmative action in support of women's business enterprises.

c. Grantees are encouraged to procure goods and services from labor surplus areas.

d. Grantor agencies may impose additional regulations and requirements in the foregoing areas only to the extent specifically mandated by statute or presidential direction.

10. Selection Procedures.

a. All procurement transactions, regardless of whether by sealed bids or by negotiation and without regard to dollar value, shall be conducted in a manner that provides maximum open and free competition consistent with this attachment. Procurement procedures shall not restrict or eliminate competition. Examples of what is considered to be restrictive of competition include, but are not limited to: (1) placing unreasonable requirements on firms in order for them to qualify to do business, (2) noncompetitive practices between firms, (3) organizational conflicts of interest, and (4) unnecessary experience and bonding requirements.

b. The grantee shall have written selection procedures which shall provide, as a minimum, the following procedural requirements:

(1) Solicitations of offers, whether by competitive sealed bids or competitive negotiation, shall:

(a) Incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured. Such description shall not, in competitive procurements, contain features which unduly restrict competition. The description may include a statement of the qualitative nature of the material, product or service to be procured, and when necessary, shall set forth those minimum essential characteristics and standards to which it must conform if it is to satisfy its intended use. Detailed product specifications should be avoided if at all possible. When it is impractical or uneconomical to make a clear and accurate description of the technical requirements, a ``brand name or equal'' description may be used as a means to define the performance or other salient requirements of a procurement. The specific features of the named brand which must be met by offerors shall be clearly stated.

(b) Clearly set forth all requirements which offerors must fulfill and all other factors to be used in evaluating bids or proposals.

(2) Awards shall be made only to responsible contractors that possess the potential ability to perform successfully under the terms and conditions of a proposed procurement. Consideration shall be given to such matters as contractor integrity, compliance with public policy, record of past performance, and financial and technical resources.

11. Method of Procurement.

Procurement under grants shall be made by one of the following methods, as described herein: (a) Small purchase procedures; (b) competitive sealed bids (formal advertising); (c) competitive negotiation; (d) noncompetitive negotiation.

a. Small purchase procedures are those relatively simple and informal procurement methods that are sound and appropriate for a procurement of services, supplies or other property, costing in the aggregate not more than $10,000. Grantees shall comply with State or local small purchase dollar

limits under $10,000. If small purchase procedures are used for a procurement under a grant, price or rate quotations shall be obtained from an adequate number of qualified sources.

b. In competitive sealed bids (formal advertising), sealed bids are publicly solicited and a firm-fixed-price contract (lump sum or unit price) is awarded to the responsible bidder whose bid, conforming with all the material terms and conditions of the invitation for bids, is lowest in price.

(1) In order for formal advertising to be feasible, appropriate conditions must be present, including, as a minimum, the following:

(a) A complete, adequate and realistic specification or purchase description is available.

(b) Two or more responsible suppliers are willing and able to compete effectively for the grantee's business.

(c) The procurement lends itself to a firm-fixed-price contract, and selection of the successful bidder can appropriately be made principally on the basis of price.

(2) If formal advertising is used for a procurement under a grant, the following requirements shall apply:

(a) A sufficient time prior to the date set for opening of bids, bids shall be solicited from an adequate number of known suppliers. In addition, the invitation shall be publicly advertised.

(b) The invitation for bids, including specifications and pertinent attachments, shall clearly define the items or services needed in order for the bidders to properly respond to the invitation.

(c) All bids shall be opened publicly at the time and place stated in the invitation for bids.

(d) A firm-fixed-price contract award shall be made by written notice to that responsible bidder whose bid, conforming to the invitation for bids, is lowest. Where specified in the bidding documents, factors such as discounts, transportation costs and life cycle costs shall be considered in determining which bid is lowest. Payment discounts may only be used to determine low bid when prior experience of the Grantee indicates that such discounts are generally taken.

(e) Any or all bids may be rejected when there are sound documented business reasons in the best interest of the program.

c. In competitive negotiation, proposals are requested from a number of sources and the Request for Proposal is publicized, negotiations are normally conducted with more than one of the sources submitting offers, and

either a fixed-price or cost-reimbursable type contract is awarded, as appropriate. Competitive negotiation may be used if conditions are not appropriate for the use of formal advertising. If competitive negotiation is used for a procurement under a grant, the following requirements shall apply:

(1) Proposals shall be solicited from an adequate number of qualified sources to permit reasonable competition consistent with the nature and requirements of the procurement. The Request for Proposals shall be publicized and reasonable requests by other sources to compete shall be honored to the maximum extent practicable.

(2) The Request for Proposal shall identify all significant evaluation factors, including price or cost where required and their relative importance.

(3) The grantee shall provide mechanisms for technical evaluation of the proposals received, determinations of responsible offerors for the purpose of written or oral discussions, and selection for contract award.

(4) Award may be made to the responsible offeror whose proposal will be most advantageous to the procuring party, price and other factors considered. Unsuccessful offerors should be notified promptly.

(5) Grantees may utilize competitive negotiation procedures for procurement of Architectural/Engineering professional services, whereby competitors' qualifications are evaluated and the most qualified competitor is selected, subject to negotiation of fair and reasonable compensation.

d. Noncompetitive negotiation is procurement through solicitation of a proposal from only one source, or after solicitation of a number of sources, competition is determined inadequate. Noncompetitive negotiation may be used when the award of a contract is infeasible under small purchase, competitive bidding (formal advertising) or competitive negotiation procedures. Circumstances under which a contract may be awarded by noncompetitive negotiation are limited to the following:

(1) The item is available only from a single source;

(2) Public exigency or emergency when the urgency for the requirement will not permit a delay incident to competitive solicitation;

(3) The Federal grantor agency authorizes noncompetitive negotiation; or

(4) After solicitation of a number of sources, competition is determined inadequate.

e. Additional innovative procurement methods may be used by grantees with the approval of the grantor agency. A copy of such approval shall be sent to OFPP.

12. Contract Pricing.

The cost plus a percentage of cost and percentage of construction cost method of contracting shall not be used. Grantees shall perform some form of cost or price analysis in connection with every procurement action including contract modifications. Costs or prices based on estimated costs for contracts under grants shall be allowed only to the extent that costs incurred or cost estimates included in negotiated prices are consistent with Federal cost principles.

13. Grantee Procurement Records.

Grantees shall maintain records sufficient to detail the significant history of a procurement. These records shall include, but are not necessarily limited to, information pertinent to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the cost or price.

14. Contract Provisions.

In addition to provisions defining a sound and complete procurement contract, any recipient of Federal grant funds shall include the following contract provisions or conditions in all procurement contracts and subcontracts as required by the provision, Federal Law or the grantor agency.

a. Contracts other than small purchases shall contain provisions or conditions which will allow for administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as may be appropriate.

b. All contracts in excess of $10,000 shall contain suitable provisions for termination by the grantee including the manner by which it will be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

c. All contracts awarded in excess of $10,000 by grantees and their contractors or subgrantees shall contain a provision requiring compliance with Executive Order 11246, entitled ``Equal Employment Opportunity,'' as amended by Executive Order 11375, and as supplemented in Department of Labor regulations (41 CFR part 60).

d. All contracts and subgrants for construction or repair shall include a provision for compliance with the Copeland ``Anti-Kickback'' Act (18 U.S.C. 874) as supplemented in Department of Labor regulations (29 CFR part 3). This Act provides that each contractor or subgrantee shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of

the compensation to which he is otherwise entitled. The grantee shall report all suspected or reported violations to the grantor agency.

e. When required by the Federal grant program legislation, all construction contracts in excess of $2,000 awarded by grantees and subgrantees shall include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 276a to a - 7) as supplemented by Department of Labor regulations (29 CFR part 5). Under this Act contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less often than once a week. The grantee shall place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The grantee shall report all suspected or reported violations to the grantor agency.

f. Where applicable, all contracts awarded by grantees and subgrantees in excess of $2,000 for construction contracts and in excess of $2,500 for other contracts which involve the employment of mechanics or laborers shall include a provision for compliance with sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327 - 330) as supplemented by Department of Labor regulations (29 CFR part 5). Under section 103 of the Act, each contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard work day of 8 hours and a standard work week of 40 hours. Work in excess of the standard workday or workweek is permissible provided that the worker is compensated at a rate of not less than 1\1/2\ times the basic rate of pay for all hours worked in excess of 8 hours in any calendar day or 40 hours in the work week. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous, or dangerous to his health and safety as determined under construction, safety and health standards promulgated by the Secretary of Labor. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

g. The contract shall include notice of grantor agency requirements and regulations pertaining to reporting and patent rights under any contract involving research, developmental, experimental or demonstration work with respect to any discovery or invention which arises or is developed in the course of or under such contract, and of grantor agency requirements and regulations pertaining to copyrights and rights in data.3 (FOOTNOTE)

(FOOTNOTE) 3HHS Department-wide provisions on inventions and patents arising out of activities assisted by a grant are in 45 CFR Parts 6 and 8. Department-wide provisions on copyrights under grants and subgrants are in 45 CFR Part 74, Subpart O. Other provisions on these topics or on rights to data may be in other terms of a grant. If any contract may give rise to works, inventions, patents, or data subject to any of these provisions, the

recipient shall place a requirement in the contract for contractor and subcontractor compliance with the provisions. The recipient need not place requirements of this kind in all contracts.

h. All negotiated contracts (except those awarded by small purchases procedures) awarded by grantees shall include a provision to the effect that the grantee, the Federal grantor agency, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract, for the purpose of making audit, examination, excerpts, and transcriptions.

Grantees shall require contractors to maintain all required records for three years after grantees make final payments and all other pending matters are closed.4 (FOOTNOTE)

(FOOTNOTE) 4For clarification of paragraph 14.h as it applies to HHS grants and subgrants, see 45 CFR 74.164.

i. Contracts, subcontracts, and subgrants of amounts in excess of $100,000 shall contain a provision which requires compliance with all applicable standards, orders, or requirements issued under section 306 of the Clean Air Act (42 U.S.C. 1857(h)), section 508 of the Clean Water Act (33 U.S.C. 1368), Executive Order 11738, and Environmental Protection Agency regulations (40 CFR part 15), which prohibit the use under non-exempt Federal contracts, grants or loans of facilities included on the EPA List of Violating Facilities. The provision shall require reporting of violations to the grantor agency and to the U.S.E.P.A. Assistant Administrator for Enforcement (EN - 329).

j. Contracts shall recognize mandatory standards and policies relating to energy efficiency which are contained in the State energy conservation plan issued in compliance with the Energy Policy and Conservation Act (Pub. L. 94 - 165).

Grantor agencies are permitted to require changes, remedies, changed conditions, access and record retention and suspension of work clauses approved by the Office of Federal Procurement Policy.

15. Contract Administration.

Grantees shall maintain a contract administration system insuring that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders.

[45 FR 37668, June 3, 1980; 45 FR 38380, June 9, 1980]

Appendix H to Part 74 -- Attachment O, ``Procurement Standards,'' of OMB Circular A - 110, ``Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations''

1. This attachment provides standards for use by recipients in establishing procedures for the procurement of supplies, equipment construction and other services with Federal funds.1 (FOOTNOTE) These standards are furnished to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal law and executive orders. No additional procurement standards or requirements shall be imposed by the Federal sponsoring agencies upon recipients unless specifically required by Federal statute or executive orders.

(FOOTNOTE) 1For the applicability of this attachment under HHS grants and subgrants, see 45 CFR 74.160 and 74.161.

2. The standards contained in this attachment do not relieve the recipient of the contractual responsibilities arising under its contracts. The recipient is the responsible authority, without recourse to the Federal sponsoring agency regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into, in support of a grant or other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of law are to be referred to such local, State or Federal authority as may have proper jurisdiction.

3. Recipients may use their own procurement policies and procedures. However, all recipients shall adhere to the standards set forth in paragraphs 3 and 4.

a. The recipient shall maintain a code or standards of conduct that shall govern the performance of its officers, employees or agents engaged in the awarding and administration of contracts using Federal funds. No employee, officer or agent shall participate in the selection, award or administration of a contract in which Federal funds are used, where, to his knowledge, he or his immediate family, partners, or organization in which he or his immediate family or partner has a financial interest or with whom he is negotiating or has any arrangement concerning prospective employment. The recipients' officers, employees or agents shall neither solicit nor accept gratuities, favors or anything of monetary value from contractors or potential contractors. Such standards shall provide for disciplinary actions to be applied for violations of such standards by the recipients' officers, employees or agents.

b. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient should be alert to organizational conflicts of interest or noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective

contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals should be excluded from competing for such procurements.2 (FOOTNOTE) Awards shall be made to the bidder/offeror whose bid/offer is responsive to the solicitation and is most advantageous to the recipient, price and other factors considered. Solicitations shall clearly set forth all requirements that the bidder/offeror must fulfill in order for his bid/offer to be evaluated by the recipient. Any and all bids/offers may be rejected when it is in the recipient's interest to do so.

(FOOTNOTE) 2HHS granting agencies have been authorized by OMB to waive this requirement for a particular procurement upon request of the recipient making the procurement.

c. All recipients shall establish procurement procedures that provide for, at a minimum, the following procedural requirements.

(1) Proposed procurement actions shall follow a procedure to assure the avoidance of purchasing unnecessary or duplicative items. Where appropriate, an analysis shall be made of lease and purchase, alternatives to determine which would be the most economical, practical procurement.

(2) Solicitations for goods and services shall be based upon a clear and accurate description of the technical requirements for the material, product or service to be procured. Such a description shall not, in competitive procurements, contain features which unduly restrict competition. ``Brand name or equal'' descriptions may be used as a means to define the performance or other salient requirements of a procurement, and when so used the specific features of the named brand which must be met by bidders/offerors shall be clearly specified.

(3) Positive efforts shall be made by the recipients to utilize small business and minority-owned business sources of supplies and services. Such efforts should allow these sources the maximum feasible opportunity to compete for contracts utilizing Federal funds.3 (FOOTNOTE)

(FOOTNOTE) 3Advice and assistance regarding the use of small or minority businesses may be obtained from the following organizations:

1. The Small Business Administration and its field offices.

2. The Office of Minority Business Enterprise, Department of Commerce.

3. The Community Services Administration.

4. The Office of Facilities Engineering, HHS, and its regional offices (for assistance in identifying minority-owned firms interested in performing construction, alteration, or renovation work).

5. The Office of Grants and Procurement, HHS.

(4) The type of procuring instruments used, e.g., fixed price contracts, cost reimbursable contracts, purchase orders, incentive contracts, shall be determined by the recipient but must be appropriate for the particular procurement and for promoting the best interest of the program involved. The ``cost-plus-a-percentage-of-cost'' method of contracting shall not be used.

(5) Contracts shall be made only with responsible contractors who possess the potential ability to perform successfully under the terms and conditions of a proposed procurement. Consideration shall be given to such matters as contractor integrity, record of past performance, financial and technical resources or accessibility to other necessary resources.

(6) All proposed sole source contracts or where only one bid or proposal is received in which the aggregate expenditure is expected to exceed $5,000 shall be subject to prior approval at the discretion of the Federal sponsoring agency.

(7) Some form of price or cost analysis should be made in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.

(8) Procurement records and files for purchases in excess of $10,000 shall include the following:

(a) Basis for contractor selection;

(b) Justification for lack of competition when competitive bids or offers are not obtained;

(c) Basis for award cost or price.

(9) A system for contract administration shall be maintained to ensure contractor conformance with terms, conditions and specifications of the contract, and to ensure adequate and timely followup of all purchases.

4. The recipient shall include, in addition to provisions to define a sound and complete agreement, the following provisions in all contracts. These provisions shall also be applied to subcontracts.

a. Contracts in excess of $10,000 shall contain contractual provisions or conditions that will allow for administrative, contractual or legal remedies in instances in which contractors violate or breach contract terms, and provide for such remedial actions as may be appropriate.

b. All contracts in excess of $10,000 shall contain suitable provisions for termination by the recipient including the manner by which termination will be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

c. In all contracts for construction or facility improvement awarded for more than $100,000, recipients shall observe the bonding requirements provided in Attachment B to this circular.4 (FOOTNOTE)

(FOOTNOTE) 4For HHS grants and subgrants, the requirements referred to are those in 45 CFR 74.16.

d. All contracts awarded by recipients and their contractors or subgrantees having a value of more than $10,000, shall contain a provision requiring compliance with Executive Order 11246, entitled ``Equal Employment Opportunity,'' as amended by Executive Order 11375, and as supplemented in Department of Labor regulations (41 CFR, part 60).

e. All contracts and subgrants in excess of $2,000 for construction or repair awarded by recipients and subrecipients shall include a provision for compliance with the Copeland ``Anti-Kick Back'' Act (18 U.S.C. 874) as supplemented in Department of Labor regulations (29 CFR, part 3). This Act provides that each contractor or subgrantee shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he is otherwise entitled. The recipient shall report all suspected or reported violations to the Federal sponsoring agency.

f. When required by the Federal program legislation, all construction contracts awarded by the recipients and subrecipients of more than $2,000 shall include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 276a to a - 7) and as supplemented by Department of Labor regulations (29 CFR, part 5). Under this Act contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less than once a week. The recipient shall place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The recipient shall report all suspected or reported violations to the Federal sponsoring agency.

g. When applicable, all contracts awarded by recipients in excess of $2,000 for construction contracts and in excess of $2,500 for other contracts that involve the employment of mechanics or laborers, shall include a provision for compliance with sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327 - 330) as supplemented by Department of Labor regulations (29 CFR, part 5). Under section 103 of the Act, each

contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard work day of 8 hours and a standard work week of 40 hours. Work in excess of the standard workday or workweek is permissible provided that the worker is compensated at a rate of not less than 1\1/2\ times the basic rate of pay for all hours worked in excess of 8 hours in any calendar day or 40 hours in the workweek. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous to his health and safety as determined under construction safety and health standards promulgated by the Secretary of Labor. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

h. Contracts or agreements, the principal purpose of which is to create, develop or improve products, processes or methods; or for exploration into fields that directly concern public health, safety or welfare; or contracts in the field of science or technology in which there has been little significant experience outside of work funded by Federal assistance, shall contain a notice to the effect that matters regarding rights to inventions and materials generated under the contract or agreement are subject to the regulations issued by the Federal sponsoring agency and the recipient. The contractor shall be advised as to the source of additional information regarding these matters.5 (FOOTNOTE)

(FOOTNOTE) 5HHS Department-wide provisions on inventions arising out of activities assisted by a grant are in 45 CFR Parts 6 and 8. Department-wide provisions on copyrights arising under grants and subgrants are in 45 CFR Part 74, Subpart O. Other provisions on these topics and on rights to data may be in other terms of a grant. If any contract may give rise to works, inventions, patents or data subject to these provisions, the recipient shall place a requirement in the contract for contractor and subcontractor compliance with the provisions.

i. All negotiated contracts (except those of $10,000 or less) awarded by recipients shall include a provision to the effect that the recipient, the Federal sponsoring agency, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.6 (FOOTNOTE)

(FOOTNOTE) 6For clarification of this requirement as it applies to HHS grants and subgrants, see 45 CFR 74.164.

j. Contracts and subgrants of amounts in excess of $100,000 shall contain a provision that requires the recipient to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act of 1970 (42 U.S.C. 1857 et seq.) and the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.) as amended. Violations shall be reported to the

Federal sponsoring agency and the Regional Office of the Environmental Protection Agency.

[45 FR 37671, June 3, 1980; 45 FR 38380, June 9, 1980]

Pt. 74, App. I

Appendix I to Part 74 -- OMB Circular A - 133 Audits of Institutions of Higher Education and Other Nonprofit Institutions

OMB Circular No. A - 133

To the Heads of Executive Departments and Establishments

Subject: Audits of Institutions of Higher Education and Other Nonprofit Institutions

1. Purpose. Circular A - 133 establishes audit requirements and defines Federal responsibilities for implementing and monitoring such requirements for institutions of higher education and other nonprofit institutions receiving Federal awards.

2. Authority. Circular A - 133 is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541.

3. Supersession. Circular A - 133 supersedes Attachment F, subparagraph 2h, of Circular A - 110, ``Uniform Administrative Requirements for Grants and other Agreements with Institutions of Higher Education, Hospitals, and other Nonprofit Organizations.''

4. Applicability. The provisions of Circular A - 133 apply to:

a. Federal departments and agencies responsible for administering programs that involve grants, cost-type contracts and other agreements with institutions of higher education and other nonprofit recipients.

b. Nonprofit institutions, whether they are recipients, receiving awards directly from Federal agencies, or are sub-recipients, receiving awards indirectly through other recipients.

These principles, to the extent permitted by law, constitute guidance to be applied by agencies consistent with and within the discretion, conferred by the statutes governing agency action.

5. Requirements and Responsibilities.The specific requirements and responsibilities of Federal departments and agencies and institutions of

higher education and other nonprofit institutions are set forth in the attachment.

6. Effective Date. The provisions of Circular A - 133 are effective upon publication and shall apply to audits of nonprofit institutions for fiscal years that begin on or after January 1, 1990. Earlier implementation is encouraged. However, until this Circular is implemented, the audit provisions of Attachment F to Circular A - 110 shall continue to be observed.

7. Policy Review (Sunset) Date. Circular A - 133 will have a policy review three years from the date of issuance.

8. Inquiries. Further information concerning Circular A - 133 may be obtained by contacting the Financial Management Division, Office of Management and Budget, Washington, DC 20503, telephone (202) 395 - 3993.

Richard G. Darman,

Director.

OMB Circular A - 133

Audits of Institutions of Higher Education and Other Nonprofit Institutions

1. Definitions. For the purposes of this Circular, the following definitions apply:

a. Award means financial assistance, and Federal cost-type contracts used to buy services or goods for the use of the Federal Government. In includes awards received directly from the Federal agencies or indirectly through recipients. It does not include procurement contracts to vendors under grants or contracts, used to buy goods or services. Audits of such vendors shall be covered by the terms and conditions of the contract.

b. Cognizant agency means the Federal agency assigned by the Office of Management and Budget to carry out the responsibilities described in paragraph 3 of this Attachment.

c. Coordinated audit approach means an audit wherein the independent auditor, and other Federal and non-federal auditors consider each other's work, in determining the nature, timing, and extent of his or her own auditing procedures. A coordinated audit must be conducted in accordance with Government Auditing Standards and meet the objectives and reporting requirements set forth in paragraph 12(b) and 15, respectively, of this Attachment. The objective of the coordinated audit approach is to minimize duplication of audit effort, but not to limit the scope of the audit work so as to preclude the independent auditor from meeting the objectives set forth in paragraph 12(b) or issuing the reports required in paragraph 15 in a timely manner.

d. Federal agency has the same meaning as the term `agency' in section 551(1) of title 5, United States Code.

e. Federal Financial Assistance.

(1) Federal financial assistance means assistance provided by a Federal agency to a recipient or sub-recipient to carry out a program. Such assistance may be in the form of:

-- Grants;

-- Contracts;

-- Cooperative agreements;

-- Loans;

-- Loan guarantees;

-- Property;

-- Interest subsidies;

-- Insurance;

-- Direct appropriations;

-- Other non-cash assistance.

(2) Such assistance does not include direct Federal cash assistance to individuals.

(3) Such assistance includes awards received directly from Federal agencies, or indirectly when sub-recipients receive funds identified as Federal funds by recipients.

(4) The granting agency is responsible for identifying the source of funds awarded to recipients; the recipient is responsible for identifying the source of funds awarded to sub-recipients.

f. Generally accepted accounting principles has the meaning specified in the Government Auditing Standards.

g. Independent auditor means:

(1) A Federal, State, or local government auditor who meets the standards specified in the Government Auditing Standards; or

(2) A public accountant who meets such standards.

h. Internal control structure means the policies and procedures established to provide reasonable assurance that:

(1) Resource use is consistent with laws, regulations, and award terms;

(2) Resources are safeguarded against waste, loss, and misuse; and

(3) Reliable data are obtained, maintained, and fairly disclosed in reports.

i. Major program means an individual award or a number of awards in a category of Federal assistance or support for which total expenditures are the larger of three percent of total Federal funds expended or $100,000, on which the auditor will be required to express an opinion as to whether the major program is being administered in compliance with laws and regulations.

Each of the following categories of Federal awards shall constitute a major program where total expenditures are the larger of three percent of total Federal funds expended or $100,000:

-- Research and Development.

-- Student Financial Aid.

-- Individual awards not in the student aid or research and development category.

j. Management decision means the evaluation by the management of an establishment of the findings and recommendations included in an audit report and the issuance of a final decision by management concerning its response to such findings and recommendations, including actions concluded to be necessary.

k. Nonprofit institution means any corporation, trust, association, cooperative or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. The term nonprofit institutions includes institutions of higher education, except those institutions that are audited as part of single audits in accordance with Circular A - 128 Audits of State and Local Governments.'' The term does not include hospitals which are not affiliated with an institution of higher education, or State and local governments and Indian tribes covered by Circular A - 128 ``Audits of State and Local Governments.''

l. Oversight agency means the Federal agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency, unless no direct funding is received. Where there is no direct funding, the Federal agency with the predominant indirect funding will assume

the general oversight responsibilities. The duties of the oversight agency are described in paragraph 4 of this Attachment.

m. Recipient means an organization receiving financial assistance to carry out a program directly from Federal agencies.

n. Research and development includes all research activities, both basic and applied, and all development activities that are supported at universities, colleges, and other nonprofit institutions. Research is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. Development is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

o. Student Financial Aid includes those programs of general student assistance in which institutions participate, such as those authorized by Title IV of the Higher Education Act of 1965 which is administered by the U.S. Department of Education and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar awards to students on a competitive basis, or for specified studies or research.

p. Sub-recipient means any person or government department, agency, establishment, or nonprofit organization that receives financial assistance to carry out a program through a primary recipient or other sub-recipient, but does not include an individual that is a beneficiary of such a program. A sub-recipient may also be a direct recipient of Federal awards under other agreements.

q. Vendor means an organization providing a recipient or sub-recipient with generally required goods or services that are related to the administrative support of the Federal assistance program.

2. Audit of Nonprofit Institutions.

a. Requirements based on awards received. (1) Nonprofit institutions that receive $100,000 or more a year in Federal awards shall have an audit made in accordance with the provisions of this Circular. However, nonprofit institutions receiving $100,000 or more but receiving awards under only one program have the option of having an audit of their institution prepared in accordance with the provisions of the Circular or having an audit made of the one program. For prior or subsequent years, when an institution has only loan guarantees or outstanding loans that were made previously, the institution may be required to conduct audits for those programs, in accordance with regulations of the Federal agencies providing those guarantees or loans.

(2) Nonprofit institutions that receive at least $25,000 but less than $100,000 a year in Federal awards shall have an audit made in accordance with this Circular or have an audit made of each Federal award, in accordance

with Federal laws and regulations governing the programs in which they participate.

(3) Nonprofit institutions receiving less than $25,000 a year in Federal awards are exempt from Federal audit requirements, but records must be available for review by appropriate officials of the Federal grantor agency or subgranting entity.

b. Oversight by Federal agencies. (1) To each of the larger nonprofit institutions the Office of Management and Budget (OMB) will assign a Federal agency as the cognizant agency for monitoring audits and ensuring the resolution of audit findings that affect the programs of more than one agency.

(2) Smaller institutions not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them with the most funds.

(3) Assignments to Federal cognizant agencies for carrying out responsibilities in this section are set forth in a separate supplement to this Circular.

(4) Federal Government-owned, contractor-operated facilities at institutions or laboratories operated primarily for the Government are not included in the cognizance assignments. These will remain the responsibility of the contracting agencies. The listed assignments cover all of the functions in this Circular unless otherwise indicated. The Office of Management and Budget will coordinate changes in agency assignments.

3. Cognizant Agency Responsibilities. A cognizant agency shall:

a. Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.

b. Provide technical advice and liaison to institutions and independent auditors.

c. Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, and provide the results, when appropriate, to other interested organizations.

d. Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any reported illegal acts or irregularities. A cognizant agency should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.

e. Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will work with the auditor to take corrective action. If corrective

action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

f. Coordinate, to the extent practicable, audits or reviews made for Federal agencies that are in addition to the audits made pursuant to this Circular, so that the additional audits or reviews build upon audits performed in accordance with the Circular.

g. Ensure the resolution of audit findings that affect the programs of more than one agency.

h. Seek the views of other interested agencies before completing a coordinated program.

i. Help coordinate the audit work and reporting responsibilities among independent public accountants, State auditors, and both resident and non-resident Federal auditors to achieve the most cost-effective audit.

4. Oversight agency responsibilities. An oversight agency shall provide technical advice and counsel to institutions and independent auditors when requested by the recipient. The oversight agency may assume all or some of the responsibilities normally performed by a cognizant agency.

5. Recipient responsibilities. A recipient that receives a Federal award and provides $25,000 or more of it during its fiscal year to a sub-recipient shall:

a. Ensure that the nonprofit institution sub-recipients that receive $25,000 or more have met the audit requirements of this Circular, and that sub-recipients subject to OMB Circular A - 128 have met the audit requirements of that Circular;

b. Ensure that appropriate corrective action is taken within six months after receipt of the sub-recipient audit report in instances of noncompliance with Federal laws and regulations;

c. Consider whether sub-recipient audits necessitate adjustment of the recipient's own records; and

d. Require each sub-recipient to permit independent auditors to have access to the records and financial statements as necessary for the recipient to comply with this Circular.

6. Relation to Other Audit Requirements.

a. An audit made in accordance with this Circular shall be in lieu of any financial audit required under individual Federal awards. To the extent

that an audit made in accordance with this Circular provides Federal agencies with the information and assurances they need to carry out their overall responsibilities, they shall rely upon and use such information. However, a Federal agency shall make any additional audits or reviews necessary to carry out responsibilities under Federal law and regulation. Any additional Federal audits or reviews shall be planned and carried out in such a way as to build upon work performed by the independent auditor.

b. Audit planning by Federal audit agencies should consider the extent to which reliance can be placed upon work performed by other auditors. Such auditors include State, local, Federal, and other independent auditors, and a recipient's internal auditors. Reliance placed upon the work of other auditors should be documented and in accordance with Government Auditing Standards.

c. The provisions of this Circular do not limit the authority of Federal agencies to make or contract for audits and evaluations of Federal awards, nor do they limit the authority of any Federal agency Inspector General or other Federal official.

d. The provisions of this Circular do not authorize any institution or sub-recipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits, evaluations or reviews.

e. A Federal agency that makes or contracts for audits, in addition to the audits made by recipients pursuant to this Circular, shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits or reviews include financial, performance audits and program evaluations.

7. Frequency of audit. Audits shall usually be performed annually but not less frequently than every two years.

8. Sanctions. No audit costs may be charged to Federal awards when audits required by this Circular have not been made or have been made but not in accordance with this Circular. In cases of continued inability or unwillingness to have a proper audit in accordance with the Circular, Federal agencies must consider appropriate sanctions including:

-- Withholding a percentage of awards until the audit is completed satisfactorily;

-- Withholding or disallowing overhead costs; or

-- Suspending Federal awards until the audit is made.

9. Audit costs. The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provisions of Circular A - 21, ``Cost

Principles for Universities'' or Circular A - 122, ``Cost Principles for Nonprofit Organizations,'' FAR subpart 31, or other applicable cost principles or regulations.

10. Auditor selection. In arranging for audit services institutions shall follow the procurement standards prescribed by Circular A - 110, ``Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and other Nonprofit Organizations.''

11. Small and Minority Audit Firms.

a. Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular.

b. Recipients of Federal awards shall take the following steps to further this goal:

(1) Ensure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable;

(2) Make information on forthcoming opportunities available and arrange timeframes for the audit to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(3) Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(4) Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs, and in cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities;

(5) Encourage contracting with consortiums of small audit firms as described in section (1), above, when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals; and

(6) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

12. Scope of Audit and Audit Objectives. a. The audit shall be made by an independent auditor in accordance with Government Auditing Standards

developed by the Comptroller General of the United States covering financial audits. An audit under this Circular should be an organization-wide audit of the institution. However, there may be instances where Federal auditors are performing audits or are planning to perform audits at nonprofit institutions. In these cases, to minimize duplication of audit work, a coordinated audit approach may be agreed upon between the independent auditor, the recipient and the cognizant agency or the oversight agency. Those auditors who assume responsibility for any or all of the reports called for by paragraph 15 should follow guidance set forth in Government Auditing Standards in using work performed by others.

b. The auditor shall determine whether:

(1) The financial statements of the institution present fairly its financial position and the results of its operations in accordance with generally accepted accounting principles;

(2) The institution has an internal control structure to provide reasonable assurance that the institution is managing Federal awards in compliance with applicable laws and regulations, and controls that ensure compliance with the laws and regulations that could have a material impact on the financial statements; and

(3) The institution has complied with laws and regulations that may have a direct and material effect on its financial statement amounts and on each major Federal program.

13. Internal Controls Over Federal Awards; Compliance Reviews. a. General. The independent auditor shall determine and report on whether the recipient has an internal control structure to provide reasonable assurance that it is managing Federal awards in compliance with applicable laws, regulations, and contract terms, and that it safeguards Federal funds. In performing these reviews, independent auditors should rely upon work performed by a recipient's internal auditors to the maximum extent possible. The extent of such reliance should be based upon the Government Auditing Standards.

b. Internal control review. (1) In order to provide this assurance on internal controls, the auditor must obtain an understanding of the internal control structure and assess levels of internal control risk. After obtaining an understanding of the controls, the assessment must be made whether or not the auditior intends to place reliance on the internal control structure.

(2) As part of this review, the auditor shall:

(a) Perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. Tests of controls will not be required for those areas where the internal control structure policies and procedures are likely to be ineffective in preventing or detecting noncompliance, in which

case a reportable condition or a material weakness should be reported in accordance with paragraph 15c(2) of this Circular.

(b) Review the recipient's system for monitoring sub-recipients and obtaining and acting on sub-recipient audit reports.

(c) Determine whether controls are in effect to ensure direct and indirect costs were computed and billed in accordance with the guidance provided in the general requirements section of the compliance supplement to this Circular.

c. Compliance review. (1) The auditor shall determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. In addition, transactions selected for non-major programs shall be tested for compliance with Federal laws and regulations that apply to such transactions.

(2) In order to determine which major programs are to be tested for compliance, recipients shall identify, in their accounts, all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies, through other State and local governments or other recipients. To assist recipients in identifying Federal awards, Federal agencies and primary recipients shall provide the Catalog of Federal Domestic Assistance (CFDA) numbers to the recipients when making the awards.

(3) The review must include the selection of an adequate number of transactions from each major Federal financial assistance program so that the auditor obtains sufficient evidence to support the opinion on compliance required by paragraph 15c(3) of this Attachment. The selection and testing of transactions shall be based on the auditors' professional judgment considering such factors as the amount of expenditures for the program; the newness of the program or changes in its conditions; prior experience with the program particularly as revealed in audits and other evaluations (e.g., inspections, program reviews, or system reviews required by Federal Acquisition Regulations); the extent to which the program is carried out through sub-recipients; the extent to which the program contracts for goods or services; the level to which the program is already subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(4) In making the test of transactions, the auditor shall determine whether:

-- The amounts reported as expenditures were for allowable services, and

-- The records show that those who received services or benefits were eligible to receive them.

(5) In addition to transaction testing, the auditor shall determine whether:

-- Matching requirements, levels of effort and earmarking limitations were met,

-- Federal financial reports and claims for advances and reimbursement contain information that is supported by books and records from which the basic financial statements have been prepared, and

-- Amounts claimed or used for matching were determined in accordance with (1) OMB Circular A - 21, ``Cost Principles for Educational Institutions''; (2) matching or cost sharing requirements in Circular A - 110, ``Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations''; (3) Circular A - 122, ``Cost Principles for Nonprofit Organizations''; (4) FAR subpart 31 cost principles; and (5) other applicable cost principles or regulations.

(6) The principal compliance requirements of the largest Federal programs may be ascertained by referring to the Compliance Supplement for Single Audits of Educational Institutions and Other Nonprofit Organizations, and the Compliance Supplement for Single Audits of State and Local Governments, issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplements, the auditor should ascertain compliance requirements by reviewing the statutes, regulations, and agreements governing individual programs.

(7) Transactions related to other awards that are selected in connection with examinations of financial statements and evaluations of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

14. Illegal Acts. If, during or in connection with the audit of a nonprofit institution, the auditor becomes aware of illegal acts, such acts shall be reported in accordance with the provisions of the Government Auditing Standards.

15. Audit Reports. a. Audit reports must be prepared at the completion of the audit.

b. The audit report shall state that the audit was made in accordance with the provisions of this Circular.

c. The report shall be made up of at least the following three parts:

(1) The financial statements and a schedule of Federal awards and the auditor's report on the statements and the schedule. The schedule of Federal awards should identify major programs and show the total expenditures for each program. Individual major programs other than Research and Development and Student Aid should be listed by catalog number as identified in the

Catalog of Federal Domestic Assistance. Expenditures for Federal programs other than major programs shall be shown under the caption ``other Federal assistance.'' Also, the value of non-cash assistance such as loan guarantees, food commodities or donated surplus properties or the outstanding balance of loans should be disclosed in the schedule.

(2) A written report of the independent auditor's understanding of the internal control structure and the assessment of control risk. The auditor's report should include as a minimum: (1) The scope of the work in obtaining understanding of the internal control structure and in assessing the control risk, (2) the nonprofit institution's significant internal controls or control structure including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and those that provide reasonable assurance that Federal awards are being managed in compliance with applicable laws and regulations, and (3) the reportable conditions, including the identification of material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk. If the auditor limits his/her consideration of the internal control structure for any reason, the circumstances should be disclosed in the report.

(3) The auditor's report on compliance containing:

-- An opinion as to whether each major Federal program was being administered in compliance with laws and regulations applicable to the matters described in paragraph 13(c)(3) of this Attachment, including compliance with laws and regulations pertaining to financial reports and claims for advances and reimbursements;

-- A statement of positive assurance on those items that were tested for compliance and negative assurance on those items not tested;

-- Material findings of noncompliance presented in their proper perspective:

QUIT The size of the universe in number of items and dollars,

QUIT The number and dollar amount of transactions tested by the auditors,

QUIT The number and corresponding dollar amount of instances of noncompliance;

-- Where findings are specific to a particular Federal award, an identification of total amounts questioned, if any, for each Federal award, as a result of noncompliance and the auditor's recommendations for necessary corrective action.

c. The three parts of the audit report may be bound into a single document, or presented at the same time as separate documents.

d. Nonmaterial findings need not be disclosed with the compliance report but should be reported in writing to the recipient in a separate communication. The recipient, in turn, should forward the findings to the Federal grantor agencies or subgrantor sources.

e. All fraud or illegal acts or indications of such acts, including all questioned costs found as the result of these acts that auditors become aware of, may be covered in a separate written report submitted in accordance with the Government Auditing Standards.

f. The auditor's report should disclose the status of known but uncorrected significant material findings and recommendations from prior audits that affect the current audit objective as specified in the Government Auditing Standards.

g. In addition to the audit report, the recipient shall provide a report of its comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

h. Copies of the audit report shall be submitted in accordance with the reporting standards for financial audits contained in the Government Auditing Standards. Sub-recipient auditors shall submit copies to recipients that provided Federal awards. The report shall be due within 30 days after the completion of the audit, but the audit should be completed and the report submitted not later than 13 months after the end of the recipient's fiscal year unless a longer period is agreed to with the cognizant or oversight agency.

i. Recipients of more than $100,000 in Federal awards shall submit one copy of the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audit reports on file.

j. Recipients shall keep audit reports, including sub-recipient reports, on file for three years from their issuance.

16. Audit resolution. a. As provided in paragraph 3, the cognizant agency shall be responsible for ensuring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single Federal agency will be the responsibility of the recipient and the agency. Alternate arrangements may be made on case-by-case basis by agreement among the agencies concerned.

b. A management decision shall be made within six months after receipt of the report by the Federal agencies responsible for audit resolution. Corrective action should proceed as rapidly as possible.

17. Audit Workpapers and Reports. Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee or the General Accounting Office, at the completion of the audit.

[56 FR 8714, Mar. 1, 1991]

Pt. 74, App. J

Appendix J to Part 74 -- OMB Circular A - 128, ``Audits of State and Local Governments''

Circular No. A - 128

April 12, 1985.

To the Heads of Executive Departments and Establishments

Subject: Audits of State and Local Governments.

1. Purpose. This Circular is issued pursuant to the Single Audit Act of 1984, Pub. L. 98 - 502. It establishes audit requirements for State and local governments that receive Federal aid, and defines Federal responsibilities for implementing and monitoring those requirements.

2. Supersession. The Circular supersedes Attachment P, ``Audit Requirements,'' of Circular A - 102, ``Uniform requirements for grants to State and local governments.''

3. Background. The Single Audit Act builds upon earlier efforts to improve audits of Federal aid programs. The Act requires State or local governments that receive $100,000 or more a year in Federal funds to have an audit made for that year. Section 7505 of the Act requires the Director of the Office of Management and Budget to prescribe policies, procedures and guidelines to implement the Act. It specifies that the Director shall designate ``cognizant'' Federal agencies, determine criteria for making appropriate charges to Federal programs for the cost of audits, and provide procedures to assure that small firms or firms owned and controlled by disadvantaged individuals have the opportunity to participate in contracts for single audits.

4. Policy. The Single Audit Act requires the following:

a. State or local governments that receive $100,000 or more a year in Federal financial assistance shall have an audit made in accordance with this Circular.

b. State or local governments that receive between $25,000 and $100,000 a year shall have an audit made in accordance with this Circular, or in accordance with Federal laws and regulations governing the programs they participate in.

c. State or local governments that receive less than $25,000 a year shall be exempt from compliance with the Act and other Federal audit requirements. These State and local governments shall be governed by audit requirements prescribed by State or local law or regulation.

d. Nothing in this paragraph exempts State or local governments from maintaining records of Federal financial assistance or from providing access to such records to Federal agencies, as provided for in Federal law or in Circular A - 102, ``Uniform requirements for grants to state or local governments.''

5. Definitions. For the purposes of this Circular the following definitions from the Single Audit Act apply:

a. Cognizant agency means the Federal agency assigned by the Office of Management and Budget to carry out the responsibilities described in paragraph 11 of this Circular.

b. Federal finanical assistance means assistance provided by a Federal agency in the form of grants, contracts, cooperative agreements, loans, loan guarantees, property, interest subsidies, insurance, or direct appropriations, but does not include direct Federal cash assistance to individuals. It includes awards received directly from Federal agencies, or indirectly through other units of States and local governments.

c. Federal agency has the same meaning as the term `agency' in section 551(1) of Title 5, United States Code.

d. Generally accepted accounting principles has the meaning specified in the generally accepted government auditing standards.

e. Generally accepted government auditing standards means the Standards For Audit of Government Organizations, Programs, Activities, and Functions, developed by the Comptroller General, dated February 27, 1981.

f. Independent auditor means:

(1) A State or local government auditor who meets the independence standards specified in generally accepted government auditing standards; or

(2) A public accountant who meets such independence standards.

g. Internal controls means the plan of organization and methods and procedures adopted by management to ensure that:

(1) Resource use is consistent with laws, regulations, and policies;

(2) Resources are safeguarded against waste, loss, and misuse; and

(3) Reliable data are obtained, maintained, and fairly disclosed in reports.

h. Indian tribe means any Indian tribe, band, nations, or other organized group or community, including any Alaskan Native village or regional or village corporations (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

i. Local government means any unit of local government within a State, including a county, a borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of government, and any other instrumentality of local government.

j. Major Federal Assistance Program, as defined by Pub. L. 98 - 502, is described in the Attachment to this Circular.

k. Public accountants means those individuals who meet the qualification standards included in generally accepted government auditing standards for personnel performing government audits.

l. State means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, and any multi-State, regional, or interstate entity that has governmental functions and any Indian tribe.

m. Subrecipient means any person or government department, agency, or establishment that receives Federal financial assistance to carry out a program through a State or local government, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a direct recipient of Federal financial assistance.

6. Scope of audit. The Single Audit Act provides that:

a. The audit shall be made by an independent auditor in accordance with generally accepted government auditing standards covering financial and compliance audits.

b. The audit shall cover the entire operations of a State or local government or, at the option of that government, it may cover departments, agencies or establishments that received, expended, or otherwise administered Federal financial assistance during the year. However, if a State or local

government receives $25,000 or more in General Revenue Sharing Funds in a fiscal year, it shall have an audit of its entire operations. A series of audits of individual departments, agencies, and establishments for the same fiscal year may be considered a single audit.

c. Public hospitals and public colleges and universities may be excluded from State and local audits and the requirements of this Circular. However, if such entities are excluded, audits of these entities shall be made in accordance with statutory requirements and the provisions of Circular A - 110, ``Uniform requirements for grants to universities, hospitals, and other nonprofit organizations.''

d. The auditor shall determine whether:

(1) The financial statements of the government, department, agency or establishment present fairly its financial position and the results of its financial operations in accordance with generally accepted accounting principles;

(2) The organization has internal accounting and other control systems to provide reasonable assurance that it is managing Federal financial assistance programs in compliance with applicable laws and regulations; and

(3) The organization has complied with laws and regulations that may have material effect on its financial statements and on each major Federal assistance program.

7. Frequency of audit. Audits shall be made annually unless the State or local government has, by January 1, 1987, a constitutional or statutory requirement for less frequent audits. For those governments, the cognizant agency shall permit biennial audits, covering both years, if the government so requests. It shall also honor requests for biennial audits by governments that have an administrative policy calling for audits less frequent than annual, but only for fiscal years beginning before January 1, 1987.

8. Internal control and compliance reviews. The Single Audit Act requires that the independent auditor determine and report on whether the organization has internal control systems to provide reasonable assurance that it is managing Federal assistance programs in compliance with applicable laws and regulations.

a. Internal control review. In order to provide this assurance the auditor must make a study and evaluation of internal control systems used in administering Federal assistance programs. The study and evaluation must be made whether or not the auditor intends to place reliance on such systems. As part of this review, the auditor shall:

(1) Test whether these internal control systems are functioning in accordance with prescribed procedures.

(2) Examine the reeipient's system for monitoring subrecipients and obtaining and acting on subrecipient audit reports.

b. Compliance review. The law also requires the auditor to determine whether the organization has complied with laws and regulations that may have a material effect on each major Federal assistance program.

(1) In order to determine which major programs are to be tested for compliance, State and local governments shall identify in their accounts all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies and through other State and local governments.

(2) The review must include the selection and testing of a representative number of charges from each major Federal assistance program. The selection and testing of transactions shall be based on the auditor's professional judgment considering such factors as the amount of expenditures for the program and the individual awards; the newness of the program or changes in its conditions; prior experience with the program, particularly as revealed in audits and other evaluations (e.g., inspections program reviews); the extent to which the program is carried out through subrecipients; the extent to which the program contracts for goods or services; the level to which the program is already subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(a) In making the test of transactions, the auditor shall determine whether:

-- The amounts reported as expenditures were for allowable services, and

-- The records show that those who received services or benefits were eligible to receive them.

(b) In addition to transaction testing, the auditor shall determine whether:

-- Matching requirements, levels of effort and earmarking limitations were met,

-- Federal financial reports and claims for advances and reimbursements contain information that is supported by the books and records from which the basic financial statements have been prepared, and

-- Amounts claimed or used for matching were determined in accordance with OMB Circular A - 87, ``Cost principles for State and local governments,'' and Attachment F of Circular A - 102, ``Uniform requirements for grants to State and local governments.''

(c) The principal compliance requirements of the largest Federal aid programs may be ascertained by referring to the Compliance Supplement for Single Audits of State and Local Governments, issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplement, the auditor may ascertain compliance requirements by researching the statutes, regulations, and agreements governing individual programs.

(3) Transactions related to other Federal assistance programs that are selected in connection with examinations of financial statements and evaluations of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

9. Subrecipients. State or local governments that receive Federal financial assistance and provide $25,000 or more of it in a fiscal year to a subrecipient shall:

a. Determine whether State or local subrecipients have met the audit requirements of this Circular and whether subrecipients covered by Circular A - 110, ``Uniform requirements for grants to universities, hospitals, and other nonprofit organizations,'' have met that requirement;

b. Determine whether the subrecipient spent Federal assistance funds provided in accordance with applicable laws and regulations. This may be accomplished by reviewing an audit of the subrecipient made in accordance with this Circular, Circular A - 110, or through other means (e.g., program reviews) if the subrecipient has not yet had such an audit;

c. Ensure that appropriate corrective action is taken within six months after receipt of the audit report in instances of noncompliance with Federal laws and regulations;

d. Consider whether subrecipient audits necessitate adjustment of the recipient's own records; and

e. Require each subrecipient to permit independent auditors to have access to the records and financial statements as necessary to comply with this Circular.

10. Relation to other audit requirements. The Single Audit Act provides that an audit made in accordance with this Circular shall be in lieu of any financial or financial compliance audit required under individual Federal assistance programs. To the extent that a single audit provides Federal agencies with information and assurances they need to carry out their overall responsibilities, they shall rely upon and use such information. However, a Federal agency shall make any additional audits which are necessary to carry out its responsibilities under Federal law and regulation. Any additional Federal audit effort shall be planned and carried out in such a way as to avoid duplication.

a. The provisions of this Circular do not limit the authority of Federal agencies to make, or contract for audits and evaluations of Federal financial assistance programs, nor do they limit the authority of any Federal agency Inspector General or other Federal audit official.

b. The provisions of this Circular do not authorize any State or local government or subrecipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits.

c. A Federal agency that makes or contracts for audits in addition to the audits made by recipients pursuant to this Circular shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits include economy and efficiency audits, program results audits, and program evaluations.

11. Cognizant agency responsibilities. The Single Audit Act provides for cognizant Federal agencies to oversee the implementation of this Circular.

a. The Office of Management and Budget will assign cognizant agencies for States and their subdivisions and larger local governments and their subdivisions. Other Federal agencies may participate with an assigned cognizant agency, in order to fulfill the cognizance responsibilities. Smaller governments not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them the most funds whether directly or indirectly.

b. A cognizant agency shall have the following responsibilities:

(1) Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.

(2) Provide technical advice and liaison to State and local governments and independent auditors.

(3) Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, and provide the results, when appropriate, to other interested organizations.

(4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any reported illegal acts or irregularities. They should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.

(5) Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will be expected to work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make

recommendations for followup action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

(6) Coordinate, to the extent practicable, audits made by or for Federal agencies that are in addition to the audits made pursuant to this Circular; so that the additional audits build upon such audits.

(7) Oversee the resolution of audit findings that affect the programs of more than one agency.

12. Illegal acts or irregularities. If the auditor becomes aware of illegal acts or other irregularities, prompt notice shall be given to recipient management officials above the level of involvement. (see also paragraph 13(a)(3) below for the auditor's reporting responsibilities.) The recipient, in turn, shall promptly notify the cognizant agency of the illegal acts or irregularities and of proposed and actual actions, if any. Illegal acts and irregularities include such matters as conflicts of interest, falsification of records or reports, and misappropriations of funds or other assets.

13. Audit Reports. Audit reports must be prepared at the completion of the audit. Reports serve many needs of State and local governments as well as meeting the requirements of the Single Audit Act.

a. The audit report shall state that the audit was made in accordance with the provisions of this Circular. The report shall be made up of at least:

(1) The auditor's report on financial statements and on a schedule of Federal assistance; the financial statements; and a schedule of Federal assistance, showing the total expenditures for each Federal assistance program as identified in the Catalog of Federal Domestic Assistance. Federal programs or grants that have not been assigned a catalog number shall be identified under the caption ``other Federal assistance.''

(2) The auditor's report on the study and evaluation of internal control systems must identify the organization's significant internal accounting controls, and those controls designed to provide reasonable assurance that Federal programs are being managed in compliance with laws and regulations. It must also identify the controls that were evaluated, the controls that were not evaluated, and the material weaknesses identified as a result of the evaluation.

(3) The auditor's report on compliance containing:

-- A statement of positive assurance with respect to those items tested for compliance, including compliance with law and regulations pertaining to financial reports and claims for advances and reimbursements;

-- Negative assurance on those items not tested;

-- A summary of all instances of noncompliance; and

-- An identification of total amounts questioned, if any, for each Federal assistance award, as a result of noncompliance.

b. The three parts of the audit report may be bound into a single report, or presented at the same time as separate documents.

c. All fraud abuse, or illegal acts or indications of such acts, including all questioned costs found as the result of these acts that auditors become aware of, should normally be covered in a separate written report submitted in accordance with paragraph 13f.

d. In addition to the audit report, the recipient shall provide comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

e. The reports shall be made available by the State or local government for public inspection within 30 days after the completion of the audit.

f. In accordance with generally accepted government audit standards, reports shall be submitted by the auditor to the organization audited and to those requiring or arranging for the audit. In addition, the recipient shall submit copies of the reports to each Federal department or agency that provided Federal assistance funds to the recipient. Subrecipients shall submit copies to recipients that provided them Federal assistance funds. The reports shall be sent within 30 days after the completion of the audit, but no later than one year after the end of the audit period unless a longer period is agreed to with the cognizant agency.

g. Recipients of more than $100,000 in Federal funds shall submit one copy of the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audits on file and follow up with State and local governments that have not submitted required audit reports.

h. Recipients shall keep audit reports on file for three years from their issuance.

14. Audit Resolution. As provided in paragraph 11, the cognizant agency shall be responsible for monitoring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single Federal agency will be the

responsibility of the recipient and that agency. Alternate arrangements may be made on a case-by-case basis by agreement among the agencies concerned.

Resolution shall be made within six months after receipt of the report by the Federal departments and agencies. Corrective action should proceed as rapidly as possible.

15. Audit workpapers and reports. Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee or the General Accounting Office, at the completion of the audit.

16. Audit Costs. The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal assistance programs.

a. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provision of Circular A - 87, ``Cost principles for State and local governments.''

b. Generally, the percentage of costs charged to Federal assistance programs for a single audit shall not exceed the percentage that Federal funds expended represent of total funds expended by the recipient during the fiscal year. The percentage may be exceeded, however, if appropriate documentation demonstrates higher actual cost.

17. Sanctions. The Single Audit Act provides that no cost may be charged to Federal assistance programs for audits required by the Act that are not made in accordance with this Circular. In cases of continued inability or unwillingness to have a proper audit, Federal agencies must consider other appropriate sanctions including:

-- Withholding a percentage of assistance payments until the audit is completed satisfactorily,

-- Withholding or disallowing overhead costs, and

-- Suspending the Federal assistance agreement until the audit is made.

18. Auditor Selection. In arranging for audit services State and local governments shall follow the procurement standards prescribed by Attachment O of Circular A - 102, ``Uniform requirements for grants to State and local governments.'' The standards provide that while recipients are encouraged to enter into intergovernmental agreements for audit and other services, analysis should be made to determine whether it would be more economical to purchase the services from private firms. In instances where use of such intergovernmental agreements are required by State statutes (e.g., audit services) these statutes will take precedence.

19. Small and Minority Audit Firms. Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular. Recipients of Federal assistance shall take the following steps to further this goal:

a. Assure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable.

b. Make information on forthcoming opportunities available and arrange timeframes for the audit so as to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals.

c. Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals.

d. Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs and, in such cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities.

e. Encourage contracting with consortiums of small audit firms as described in paragraph (a) above when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals.

f. Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

20. Reporting. Each Federal agency will report to the Director of OMB on or before March 1, 1987, and annually thereafter on the effectiveness of State and local governments in carrying out the provisions of this Circular. The report must identify each State or local government or Indian tribe that, in the opinion of the agency, is failing to comply with Circular.

21. Regulations. Each Federal agency shall include the provisions of this Circular in its regulations implementing the Single Audit Act.

22. Effective date. This Circular is effective upon publication and shall apply to fiscal years of State and local governments that begin after December 31, 1984. Earlier implementation is encouraged. However, until it is implemented, the audit provisions of Attachment P to Circular A - 102 shall continue to be observed.

23. Inquiries. All questions or inquiries should be addressed to Financial Management Division, Office of Management and Budget, telephone number 202/395 - 3993.

24. Sunset review date. This Circular shall have an independent policy review to ascertain its effectiveness three years from the date of issuance.

David A. Stockman,

Director.

Circular A - 128 Attachment

Definition of Major Program as Provided in Pub. L. 98 - 502

Major Federal Assistance Program, for State and local governments having Federal assistance expenditures between $100,000 and $100,000,000, means any program for which Federal expenditures during the applicable year exceed the larger of $300,000, or 3 percent of such total expenditures.

Where total expenditures of Federal assistance exceed

(TABLE START)$100,000,000, the following criteria apply:

@h1Total expenditures of Federal financial assistance for all programs
@h2More than @h2But less than
@h1Major Federal assistance program means any program that exceeds

$100 million ..... 1 billion ..... $3 million

1 billion ..... 2 billion ..... 4 million

2 billion ..... 3 billion ..... 7 million

3 billion ..... 4 billion ..... 10 million

4 billion ..... 5 billion ..... 13 million

5 billion ..... 6 billion ..... 16 million

6 billion ..... 7 billion ..... 19 million

Over 7 billion .... 20 million

(TABLE END)

[50 FR 31716, Aug. 6, 1985]